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FEDERAL DEBT-MANAGEMENT POLICIES, 1865-1879

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Robert T. Patterson

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To My Father and Mother

RICHARD SHARPE PATTERSON

and

MARY COXE PATTERSON

Preface

In recent years attention has turned more and more to the debt of the Federal government and the role it plays in the economic life of the nation. It is not a new conception, however, that the management of a large government debt is a powerful force in the national economy and that debt-management policy is necessarily a part of all fiscal and monetary policy. In the period following the Civil War the significance of this relationship was recognized both in government and in the world of business and finance. It has seemed to me that the experience then with a large and unwieldy debt and a fiat paper currency may be profitably reviewed by those to whom the fiscal and monetary problems of the present are of interest and concern.

My obligations in this work are many. Members of the staff of the libraries of New York University have been very helpful. To them and to the assistants in the New York Public Library, in its Main Reading Room, the Division of History, and the Division of Economics and Sociology, my sincere thanks. As for the Library of Congress, I can only conjecture who and how many shared in the aid to research; but through their chief, Colonel Willard Webb, I wish to express my appreciation.

To the late Professor Gaylard Hawkins Patterson, who introduced me to the study of economics and its place in the world of knowledge, my long-remembered gratitude. Professor Paul Studenski, of New York University, was my mentor in this work. He suggested the project, fostered it critically, and favored it with insight and tolerance. To Professor Walter E. Spahr my thanks for reading the manuscript and for suggestions and encouragement. I am indebted to my brother, Richard S. Patterson, for help and

suggestions; and to Mr. Richard U. Bashor for a critical reading of the manuscript. I alone, however, am responsible for the limitations, interpretations, and conclusions of this study.

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My thanks are also due to the following publishers for permission to quote from the books indicated:

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Washington, D. C. ROBERT T. PATTERSON

January, 1954

Contents

		PAGE
	PREFACE	vii
I.	INTRODUCTION	3
II.	GOVERNMENT FINANCE ON THE EVE OF THE CIVIL WAR	8
	Comparison of Wartime Financial Policies	9
	Deficit Financing before the War	11
	Decline of the Public Credit	13
	The Nature of Prewar Finance	17
III.	DEBT POLICIES OF THE WAR	19
	Efforts to Obtain Funds in Europe	20
	Inconsistency in Interest-Rate Policy	23
	Debt Policy and the Suspension of Specie Payments	25
	The Legal-Tender Acts and the National-Banking Acts as Expressions of Debt Policy	27
	The Sale of Bonds at Par for Greenbacks	29
	Sources of Debt Policy	30
	Secretary Chase's "Objectives"	35
	The Policies of Secretary Fessenden	37
IV.	THE DEBT AT WAR'S END	44
	The Nature and Structure of the Debt	44
	Transition from War to Peace	48
	The Debt at Its Maximum	50
	Public Opinion and the War Debt	51
V.	PRELIMINARY FUNDING OF THE SHORT-TERM DEBT	59
	Objectives and Policies of Secretary McCulloch	59
	The Short-Term Nature of the Debt	61
	The Loan Act of 1866	64
	The Conversion Operations	66
	Threats of Repudiation	71
	The Essential Soundness of the Conversion Policy	74

PAGE

VI. Refunding the Debt 78
Preparation for Refunding 78
Provisions of the Loan Act of 1870 81
A Major Error in Debt Policy 83
Some Conjectures 90
The Refunding Operations 92
Sale of the 5-per-cent Loan, 92; The European Market, 99; Commissions, 100; Calling the Old Bonds, 103; Sale of the 4½-per-cent Refunding Loan, 104; Attempts to Popularize the Debt, 106; The Rapid Completion of the Refunding Program, 110

VII. Debt Reduction and Tax Policy 113
Surplus Treasury Receipts and the Real Extent of Debt Reduction 113
The Tax-Reduction Controversy 115
Gradual Reduction in Taxes 119
The Tariff and the Debt 127
The Significance of Debt Reduction 130

VIII. The Sinking Fund as a Mechanism for Debt Reduction 134
The Influence of British Sinking-Fund Theory 134
Desuetude of the Civil War Sinking-Fund Law 137
The Revival, Operation, and Reinterpretation of the Sinking-Fund Law 138
Common Sense and the Sinking Fund 141

IX. The Exemption of Government Securities from Taxation 143
The Tax-Exemption Controversy 143
The Advantages of Tax Exemption 145

X. Monetary Policy in Relation to Debt Management, 1865-1868 148
The Currency 149
Kinds and Amounts of Currency, 149; Bank-Note, Coin, and "Deposit" Currency, 151; Government Debt as Currency, 157

PAGE

The Relation of the Independent Treasury to the National Banks and the Money Market 159

Secretary McCulloch's Currency-Contraction Policy .. 163

The Lost Opportunity to Resume Specie Payments, 164; The Anticipated Effect of Contraction, 167; The Increased Need for Currency and the Redundant Supply of It, 168; Treasury Control over the Money Market, 171; Increasing Opposition and the End of the Contraction Policy, 175

XI. Monetary Policy in Relation to Debt Management, 1869-1879 180

Secretary Boutwell's Greenback Policy 180

Secretary Richardson and the Panic of 1873 184

Veto of the Inflation Bill 187

The Resumption Act 189

Preparation for Resumption and the Forces Opposed to It 190

The Inflationary Effects of Debt and Monetary Policy 196

XII. The Effect of Debt-Management Policies on Capital Funds 200

Effect on the Investment Market 200

Effect on the Price of Gold 202

Effect on the International Balance of Payments 203

The Flow of Government Securities to Europe and Their Return, 203; Large Debt Operations in Foreign Markets, 207

Effect on Production, Distribution, and Consumption 210

XIII. A Summary of Debt-Management Objectives, 1865-1879 215

Bibliography 221

Index 237

FEDERAL DEBT-MANAGEMENT POLICIES, 1865-1879

CHAPTER I

Introduction

A LARGE Federal debt has been a consequence of every major war in which the United States has engaged. The debt of each such war has been greater than that of the preceding war. The size of the debt and the way in which it was managed were each time matters of great concern. The debt today is ten times as large as that of the First World War, and one hundred times that of the Civil War. Yet in its time the Civil War debt was considered enormous. Since the existence of the debt was a hard fact and since there was no ready means to do away with it, its management was a serious problem. The present-day question of debt management has been widely discussed, and a number of theories concerning it have been developed. Some of them differ radically, and none has received general acceptance among authorities in the field. Under such circumstances an inquiry into the nature and effects of debt-management policies in a former period seems appropriate.

It might be contended that no two periods of history are alike and that the complex economic and social structure of the present time makes this period incomparable with any previous one. The fact is, however, that at all times the basic, fundamental realities of economic life remain the same; and by making allowance for differences in the superficial or transitory aspects, useful comparisons can be drawn between two or more periods of economic experience. Moreover, the very complexity of the present economic and social structure renders it desirable to turn for examination and study to an earlier and somewhat simpler situation.

For this purpose the fourteen years of debt management between the termination of the Civil War and the resumption of

specie payments have been selected. There was, in the first several of those years, just as there is today, a large unfunded war debt. Its influence pervaded the economy, and its management was the major fiscal problem.

Present-day problems of the debt have been made highly complex by reason of the extensive development of the administrative branch of the government, in which a multitude of agencies serve a variety of purposes concerned in one way or another with fiscal and monetary policy. Back of this elaborate implementation of policy is the modern concept of the larger role of government in the economy. In this broader concept of fiscal and monetary policy, and in the development of more elaborate institutions for its application, lie the chief differences—so far as the problem of the debt is concerned—between the post-Civil War period and the present.

None of these differences, however, makes the two periods incomparable. Far more similarities than differences are evident, and the important similarities are fundamental, while the differences are not. That is to say, the basic realities of economic life finally govern and limit all arrangements intended to facilitate the production, distribution, and consumption of wealth. Primary human motives and needs have remained unchanged; the nature of real wealth is basically the same. The true nature of money and of debt, however these may be manipulated, has not changed.

Debt management is a part of fiscal policy, yet it is closely related to monetary policy. It is interwoven with all matters of revenue, expenditure, and borrowing, as well as currency and banking. It is also closely related to all business activity, being an influence upon it and, in turn, being influenced by it. A study of debt management in any period therefore becomes a study of the whole economy from a particular standpoint. The inherent relationship of the currency, taxation, and the debt makes it impossible to consider any one of them as separate from the others. Obviously, debt management is also affected by the nature of the debt. For this reason, the way in which the debt was created, the purposes it served, and the forms it took are considered at some length in order to appraise the problems of its subsequent management.

Although the modern concept of the larger role of government in the economy prescribes a broader purpose for debt management, in this earlier period debt-management policies extended consider-

ably beyond management merely for the sake of the debt. This fact is most apparent in the relationship of the Treasury to the money market, where debt operations were conducted with a regard for financial stability and the welfare of business. Debt-management policy was concerned not only with the melioration of the ill effects of the debt, but it sought also to compensate for the inadequacies of the contemporary Treasury, banking, and currency systems. It endeavored, too, to aid monetary and fiscal policy and to give some stability to the price level, the loan markets, and business activity.

In a period when the concept of the role of fiscal policy was extremely restricted, it was realized, nevertheless, that the functions of debt management did influence greatly the whole economy. Among the various fiscal policies of the government, those concerned with the management of the debt were perhaps of greatest consequence. Especially was this true concerning the aspects of debt management that affected monetary policy.

It will be seen that the problem of the Civil War debt was greatest in the first several years following the war. It diminished in importance as the debt was brought under control and as its size and burden became less. After the panic of 1873, when surplus revenues were small and refunding progressed slowly, debt operations were on a reduced scale until a revival of business confidence set in as preparations were being completed to resume specie payments on the currency portion of the debt. Although the years 1865 through 1868 were the most critical so far as the influence of the debt was concerned, policies dealing with its management continued to be of importance throughout the greater period examined in this study.

Between 1865 and 1879 there were three phases of debt-management activity. (1) The first ended in 1868 with the completion of the preliminary funding, which was designed to extend the dates of payment of the debt. (2) From 1869 to 1877 emphasis was upon refunding and consolidation, with a view to spreading the maturities of the debt over a long period of years and to reducing the interest burden. (3) In 1877 and 1878 preparation for the resumption of specie payments dominated debt policies. Parallel with these three objectives was the over-all one of restoring the value of the currency and placing the credit of the country upon a sound basis.

This study and its background extend from the administration of President Buchanan through those of Presidents Lincoln, Johnson, and Grant, and into that of President Hayes. The Secretaries of the Treasury and their terms of office during this time were:

Howell Cobb, of Georgia, March 7, 1857—December 8, 1860.
Philip F. Thomas, of Maryland, December 12, 1860—January 14, 1861.
John A. Dix, of New York, January 15, 1861—March 6, 1861.
Salmon P. Chase, of Ohio, March 7, 1861—June 30, 1864.
William P. Fessenden, of Maine, July 5, 1864—March 3, 1865.
Hugh McCulloch, of Indiana, March 9, 1865—March 3, 1869.
George S. Boutwell, of Massachusetts, March 12, 1869—March 16, 1873.
William A. Richardson, of Massachusetts, March 17, 1873—June 3, 1874.
Benjamin H. Bristow, of Kentucky, June 4, 1874—June 20, 1876.
Lot M. Morrill, of Maine, July 7, 1876—March 9, 1877.
John Sherman, of Ohio, March 10, 1877—March 3, 1881.[1]

The gross Federal debt at the end of each fiscal year was as follows:

1857	$ 28,701,375	1869	$2,545,110,590
1858	44,913,424	1870	2,436,453,269
1859	58,498,381	1871	2,322,052,141
1860	64,843,831	1872	2,209,990,838
1861	90,582,417	1873	2,151,210,345
1862	524,177,955	1874	2,159,932,730
1863	1,119,773,681	1875	2,156,276,649
1864	1,815,830,814	1876	2,130,845,778
1865	2,677,929,012	1877	2,107,759,903
1866	2,755,763,929	1878	2,159,418,315
1867	2,650,168,223	1879	2,298,912,643
1868	2,583,446,456	1880	2,090,908,872[2]

During the post-Civil War period a variety of views regarding debt management, some of an extreme nature, found expression among the people and within the government. It was to become apparent that two irreconcilable economic philosophies—those of inflation and deflation—dominated the field. Between these extremes were opinions representing all degrees of conservatism and so-called liberalism. It is significant that the persistent, sometimes

[1] United States Treasury Department, Division of Public Relations, *The United States Treasury* (Washington, n.d.), pp. 34-35.

[2] *Annual Report of the Secretary of the Treasury on the State of the Finances* (hereinafter referred to as *Treasury Report*), 1950, p. 490.

clamorous demands of those who proposed measures not consistent with meeting in full the obligation which the debt represented were enough to depreciate the government's credit and add to the difficulty and expense of converting and refunding the debt.

Among the problems which the following analysis undertakes to consider, particular attention is given to the effect of Federal debt-management policies on the debt itself, and to the relationship of those policies to other fiscal and monetary policies and to business and finance; to the close and important relationship of the debt, the currency, and the tax system; to the effect of debt-management policies and proposals of policy upon the public credit, and the effect of the status of the public credit upon the management of the debt; to the effect of debt management upon the production, distribution, and consumption of wealth, the allocation of resources, and the formation of capital; and to the limitations on debt management set by political feasibility, human fallibility, and the motives of individuals and groups. Especially important is the way in which the great war debt dominated the loan markets, and how through the interrelationship of debt policy and monetary policy its management affected every aspect of the economy.

The sources upon which this study is based are, primarily, documents of the United States Government, contemporary periodicals, pamphlets, and books, and the later private writings of persons who were active in the events of the period. In addition, more recent writings have contributed to the work. Where the contribution has been of an indirect or general nature, it has not been practicable to give credit in the footnotes. Acknowledgment is therefore made in the bibliography. Throughout the study the *Annual Report of the Secretary of the Treasury on the State of the Finances* is referred to as *Treasury Report.* The reports of other Treasury and governmental officials which accompany the Secretary's report in the House Executive Document series are designated as the report of the particular official—for example, *Report of the Treasurer of the United States,* 1867, and *Report of the Comptroller of the Currency,* 1872. Although some of these reports have been published separately, the pagination herein indicated is that of the document serial volume in which they appear with the report of the Secretary of the Treasury.

CHAPTER II

Government Finance on the Eve of the Civil War

During the Civil War a great debt was incurred under most inauspicious circumstances. The credit of the government deteriorated rapidly while the exigencies of the war and the great scale on which it was conducted made each financial measure an urgent one. The war represented an extreme national effort, both for the North and for the South. During its course a huge fund of labor and natural resources was consumed. At the same time that the national product was greatly enlarged by the intensified efforts of the people, wealth was destroyed and the productive functioning of the economy was distorted by the priorities of military requirements. Finally, in the South, loss and destruction were enormous. Economic activity almost came to a standstill; recovery was slow and difficult. Probably the Civil War consumed more of the labor and natural resources of the country than were later to be given over to the prosecution of the First World War by the United States.

The debt which came into existence as a result of the financial measures of the Civil War was far less than the actual cost of the war, even to the North alone. Yet it was, for those times, staggering. Both because of its size and because of its form and complexity, the management of it became the primary problem of fiscal and monetary policy. The circumstances under which the debt was created, the purposes it served, and the forms it took were to have an important bearing upon the nature of the policies later concerned with it.

Financially the Federal government was more poorly prepared for war in the early months of 1861 than it had been since its establishment. The financial policies of the government in the period preceding the war had weakened its credit. This, along with the

urgency of the conflict, was to make short-term borrowing and the printing of paper money attractive but costly wartime expedients. Although the failure to finance the war on a sound basis cannot be ascribed merely to prewar financial conditions and policies, the stage had been set by them. The regression to earlier methods of war finance began even before the war.

Comparison of Wartime Financial Policies

Both the Revolution and the War of 1812 had been badly financed. In each of those wars there was inadequate taxation and too great reliance upon forms of debt which increased the money supply. In both conflicts the injury to the government's credit and the depreciation in the value of the dollar added enormously to war costs and placed a heavy burden upon all classes except those which could adapt to or exploit the results of inflation.

During the Revolution stark necessity had compelled a weak national government to resort to the printing of bills of credit. Requisitions upon the states—the only form of taxation possible for the Continental Congress—yielded little; receipts from foreign and domestic loans were far less than the remainder needed to prosecute the war; and the Bank of North America, established late in the war, could help only with small and temporary advances to the government. The bills of credit circulated as currency and were in effect a loan forced upon the people. As more and more of them were issued they depreciated rapidly until at one time their value was 1,000 to 1 in terms of specie. The inflation resolved itself in almost complete destruction of the government's credit and general financial collapse.[1]

The government could have been well prepared for the War of 1812. The probability of conflict had been widely recognized for some time before. In eleven of the twelve years preceding the war there had been Treasury surpluses, and the Federal debt had been reduced by almost half. The ability of the people to bear taxation was great, for no internal taxes were then being levied. Yet as war approached Congress refused to tax, authorizing loans instead. Soon after war was declared Treasury notes were sold. Bond and note issues followed at frequent intervals. Receipts from revenue measures enacted after many delays came too late to sustain the

[1] Davis R. Dewey, *Financial History of the United States* (12th ed.; New York: Longmans, Green, & Co., 1934), pp. 34-59.

public credit; and there was no adequate banking mechanism to which the government could turn for temporary help. As the government's credit declined and its bonds sold only at greater and greater discounts, more and more notes were authorized, the smaller denominations entering directly into circulation as currency. The decline in the government's credit and the depreciation of the dollar were so great that, according to one authority, for more than $80 million of bonds which were sold only $34 million in specie value was obtained.[2]

During the Civil War period enlightened individuals in both government and private life were aware of the catastrophe of Revolutionary finance and the degradation of the government's credit in the War of 1812. Yet those who formulated and carried out the financial policies of the Civil War turned away from experience and repeated the major errors of the previous wars. Again Congress failed to provide adequate taxation, and again, early in the war, resort was had to short-term notes. Notes payable on demand were also issued. Before the first year of war had passed there began a series of legal-tender issues which gave impetus to the rising level of prices and induced wild speculation in specie and in many lines of business, enriching a few persons at the expense of many. The establishment of the national banking system came too late for it to aid the government in any substantial way.

When in September, 1865, the gross Federal debt exceeded $2.8 billion—a staggering sum for those times—over 60 per cent of it was represented by short-term obligations and irredeemable notes. Forty per cent of this short-term and irredeemable part of the debt was legal tender: about 14 per cent was legal tender, but bearing interest and being redeemable; 26 per cent was legal tender, bearing no interest, and being irredeemable.[3] The irredeemable legal-tender obligations were outright fiat paper money. The longer-term part of the debt consisted of bonds, redeemable in gold, which had been sold at par for greatly depreciated paper currency. A considerable part of the cost of the war was solely attributable to the inflationary fiscal policies of the government.[4] The credit of the

[2] *Ibid.*, pp. 119-142.

[3] *Cf. Treasury Report*, 1867, pp. iii-iv.

[4] Wesley Clair Mitchell, *A History of the Greenbacks* (Chicago: University of Chicago Press, 1903), p. 419; Don C. Barrett, *The Greenbacks and Resumption of Specie Payments* (Cambridge, Mass.: Harvard University Press, 1931), p. 72.

government was not fully restored until fourteen years after the war had ended.

Deficit Financing before the War

Between the fiscal years 1856 and 1861 revenues declined from $74.1 million to $41.5 million, but expenditures were reduced scarcely at all.[5] The cumulative deficit at the beginning of the war was approximately $65 million.[6] Deficit financing was instituted late in 1857. Tariff reduction in March of that year and the panic which began in August marked a transition in government finance from eight years of surplus to eight years of deficit. Under the tariff act of 1857 many raw materials were placed on the free list and the rates on manufactured goods were generally reduced to the lowest level since 1815.[7] As a result of the panic and the ensuing depression imports declined sharply, and Treasury receipts fell off correspondingly, for customs duties were nine-tenths of the government's total revenue. The deficiency was met for a time by the sale of $20 million one-year Treasury notes. Each year these notes were reissued as they came due, and no attempt was made to fund them until late in 1860.[8]

That long-term borrowing was possible is seen in the placement of the loan of 1858. To obtain additional funds with which to sustain the Treasury, Congress authorized a $20 million fifteen-year 5-per-cent loan,[9] half of which was negotiated before December, 1858.[10] By July, 1859, nearly all of the remainder had been sold.[11] The entire issue brought premiums ranging from 2 to 7 per cent.[12] Congress did nothing, however, to increase the revenue. Hope prevailed that there would be a revival of business, an increase in imports, and restoration of the government's income to a level that would permit payment of the notes and reduction

[5] Average annual expenditures, 1857-1861, were $68.1 million, compared with expenditures of $69.6 million in 1856 (*Treasury Report,* 1950, pp. 449, 451).

[6] Estimate based on data in *idem;* and *Report of the Secretary of the Treasury, July 4, 1861* (Sen. Ex. Doc. No. 2, 37th Cong., 1st Sess.), p. 18.

[7] F. W. Taussig, *The Tariff History of the United States* (8th ed.; New York: G. P. Putnam's Sons, 1931), p. 157.

[8] Rafael A. Bayley, *The National Loans of the United States, from July 4, 1776 to June 30, 1880* (2d ed; Washington: Government Printing Office, 1882), pp. 74-75.

[9] Act of June 14, 1858, 11 Statutes 365.

[10] *Treasury Report,* 1858, p. 15.

[11] *Ibid.,* 1859, pp. 10, 21.

[12] Bayley, *op. cit.,* p. 74.

of the funded debt.[13] The Secretary of the Treasury, Howell Cobb, did not want to add the amount of the notes originally issued in 1857 to the permanent debt by funding them, yet he realized that it would not be feasible to attempt to redeem them all in one year. He urged a revision of the tariff so that it would yield sufficient revenue to allow gradual redemption of the notes.[14] But Congress took no action until the spring of 1860. At that time a bill providing moderately higher duties passed the House, but was not taken up by the Senate before adjournment.

On June 22, 1860, Congress authorized the issue of $21 million of bonds to bear not more than 6 per cent interest and to mature in not less than ten nor more than twenty years.[15] The purpose of the authorization was to fund into long-term debt the outstanding Treasury notes which, as of June 30, 1860, amounted to $19,690,500 in a total debt of $64,769,703.08.[16] Early in September $10 million of the bonds, bearing 5 per cent interest, were offered. They were readily subscribed to at par and above.[17] But the delay in offering them was to have serious consequences. Up to that time the government had been able to finance the years of deficit since 1857 by the sale of its obligations to a willing market. So rapid, however, was the deterioration of the political and financial situation late in 1860 that nearly $3 million of the bonds were not taken up by those who had subscribed.[18]

The notes of 1857, all of one-year maturity, had been reissued continuously as they were returned to the Treasury. The sale of bonds in advance of the maturity of the notes to provide the funds for their payment would seem to have been ordinary good management. Yet the bonds authorized on June 22 were not offered for subscription until September 8.[19] Secretary Cobb gave the following explanation for the delay:

To have negotiated the whole amount thereof, or any portion, in advance of the notes falling due, would have subjected the Government

[13] Albert S. Bolles, *The Financial History of the United States from 1789 to 1860* (3d ed.; New York: D. Appleton & Co., 1891), p. 599.
[14] *Treasury Report*, 1858, p. 16.
[15] 12 Statutes 79.
[16] *Treasury Report*, 1860, pp. 8, 22.
[17] *Ibid.*, p. 8.
[18] The amount sold was $7,022,000 (*Letter from the Secretary of the Treasury to the Chairman of the Committee of Ways and Means, January 18, 1861*, H. Misc. Doc. No. 20, 36th Cong., 2d Sess., pp. 4-5).
[19] *Treasury Report*, 1860, p. 8.

to the unnecessary payment of interest during the time the money would have remained in the vaults of the treasury uncalled for. There was no power in the department to call in the treasury notes until they became due. Besides, the withdrawal of such an amount of specie from the public would have been attended with the most injurious effects upon the financial operations of the country.[20]

Of these two reasons for delay in offering the bonds the first was specious. The amount saved by avoiding payment of double interest for a few months was small; and criticism for insuring the success of the funding in this way could hardly have been dramatized in the political contest that autumn, the great issues of which were already before the people. The second reason—that withdrawing and holding so large a sum in specie from circulation pending payment of the notes would cripple industry and commerce—was valid. The nature of the Independent Treasury system was such that danger of a money and credit stringency and possible panic would have been very great.

Decline of the Public Credit

Suddenly the Treasury was in a difficult position. The financial crisis in the autumn of 1860 and the grave political uncertainties of the time had upset all calculations. An increasing proportion of the diminishing customs receipts was being received in the form of Treasury notes not yet due. Maturing notes drained funds from the Treasury and would continue to do so during the remainder of the fiscal year 1861.[21]

The Secretary considered it hopeless to attempt to negotiate the remainder of the bonds on reasonable terms. Accordingly, he asked Congress to repeal the authorization for the $11 million as yet unoffered and authorize the issue of the same amount in Treasury notes. He said in his report:

> I make this recommendation of substituting treasury notes for stock the more readily from the conviction that there should always exist in the department power to issue treasury notes for a limited amount, under the direction of the President, to meet unforeseen contingencies. It is a power which can never be abused, as the amount realized from such source can only be used to meet lawful demands upon the treasury.

[20] *Ibid.*

[21] *Ibid.* See also John Sherman, *Recollections of Forty Years in the House, Senate, and Cabinet* (Chicago: The Werner Co., 1895), I, 214, 251-253.

No Secretary of the Treasury or President would ever exercise it except compelled to do so by the exigencies of the public service. On the other hand, it would enable the government to meet without embarrassment those sudden revulsions to which the country is always liable, and which cannot always be anticipated.[22]

At that time he made the suggestion that the public lands be pledged for all the notes it might be necessary to issue.[23] The proposal was considered but not acted upon,[24] apparently for fear of impeding enactment of the Homestead Bill, which had passed the House[25] and gone to the Senate. Although Congress did not repeal the unsold part of the earlier authorization, it promptly provided for the issue of $10 million in Treasury notes. The authorization required that they be issued at par, at interest rates offered by the lowest bidders, following at least ten days of public advertisement.[26]

On December 18, 1860, proposals were sought for $5 million of the new authorization. Offers were received for only $1,831,000 at interest rates ranging up to 12 per cent. These were accepted. Other bids totaling $465,000 at interest rates of 15 to 36 per cent were rejected. Yet it was urgently necessary to negotiate the full $5 million of the loan before January 1 in order to meet interest then due on government bonds as well as to provide for redemption of maturing Treasury notes. The Bank of Commerce, in New York, acting for the account of others, subscribed for the remainder of the issue, just before that date, at the 12-per-cent rate.[27]

In the following month the remainder of the notes was offered. General John A. Dix, who had become Secretary of the Treasury on January 15,[28] promptly sought bids for them. On the nineteenth they were awarded at interest rates which averaged 10⅝ per cent.[29]

[22] *Treasury Report*, 1860, p. 9.
[23] *Ibid.*, pp. 8-9.
[24] *Congressional Globe*, 36th Cong., 2d Sess., Dec. 10, 1860, pp. 41-45.
[25] *Ibid.*, Dec. 5, 1860, p. 14.
[26] Act of Dec. 17, 1860, 12 Statutes 121.
[27] H. Misc. Doc. No. 20, 36th Cong., 2d Sess., p. 3.
[28] Secretary Cobb had resigned on Dec. 8, 1860. He was succeeded for a brief period by Philip F. Thomas. Cobb felt that his duty to the state of Georgia required his withdrawal from the Treasury Department. John Sherman, who was at that time Chairman of the House Committee of Ways and Means and who was sometimes strongly partisan in his views, long afterward maintained that Cobb "had aided in every possible way to cripple the department while in charge of it" (*Recollections*, I, 251).
[29] John Jay Knox, *United States Notes* (New York: Charles Scribner's Sons, 1884), pp. 76-77.

Notwithstanding the sums thus acquired, the situation of the Treasury in December and January continued critical. Public creditors demanded payment, and overdue Treasury notes were pressed for redemption, while the Treasurer was unable to draw sufficient sums in drafts for payment at New York where the holders wished the remittances made. By mid-January there had accumulated some $350,000 of warrants which the Treasurer was unable to pay.[30]

To fortify the government's failing credit and to make its obligations again attractive to investors, Secretary Dix proposed that the twenty-six states with which more than $28 million of surplus funds had been deposited in 1837 should permit the pledge of those deposits as security for further government borrowing.[31] A somewhat similar suggestion current at about that time was that New York, Pennsylvania, Ohio, and Massachusetts endorse the Federal government's obligations and thereby enable it to obtain par for them.[32] Both proposals came to nought.

There were two more loan enactments during the Buchanan administration. The Act of February 8, 1861,[33] authorized a ten- to twenty-year loan of $25 million at 6 per cent, bids above or below par being acceptable. Of this amount, Secretary Dix succeeded in negotiating $8,006,000 at rates ranging from 90.15 to 96.10.[34] The Act of March 2, 1861,[35] authorizing a $10 million ten- to twenty-year loan, stipulated interest not to exceed 6 per cent. The law also provided that, in case the loan could not be sold on reasonable terms, Treasury notes to be redeemed within two years and bearing no more than 6 per cent could be issued in lieu of it and also of "the whole or any part of the [other] loans . . . now by law authorized."[36]

Prewar loan authorizations sustained the Treasury in its precarious position into the summer of 1861.[37] Until that time the

[30] H. Misc. Doc. No. 20, 36th Cong., 2d Sess., p. 2.
[31] *Ibid.*, pp. 6-7.
[32] *Harper's Weekly*, V (Feb. 23, 1861), 114; and Sherman, *op. cit.*, I, 251-252.
[33] 12 Statutes 129.
[34] Sen. Ex. Doc. No. 2, 37th Cong., 1st Sess., p. 11.
[35] 12 Statutes 178.
[36] *Ibid.* Eventually, under this act, $35,364,450 of Treasury notes were issued. Of them, $22,468,100 were redeemable in two years, and $12,896,350 were redeemable in sixty days. Many of the notes were paid out directly to creditors (Bayley, *op. cit.*, pp. 76-77; Knox, *op. cit.*, p. 79).
[37] Knox, *op. cit.*, p. 83; and Albert S. Bolles, *The Financial History of the United States from 1861 to 1885* (New York: D. Appleton & Co., 1886), pp. 6-10.

administration was obliged to rely upon unused authorizations under the Acts of June 22, 1860, February 8, 1861, and March 2, 1861.[38] The increased import duties provided by the Act of March 2 strengthened the government's credit to some extent and made possible, early in April, the sale of $3,099,000 more of the bonds authorized on February 8 at prices ranging from 94 to par. Soon after, $4,901,000 of Treasury notes were sold at par and above.[39]

STATUS OF LOAN AUTHORIZATIONS AT THE OUTBREAK OF THE WAR

Act of June 22, 1860	
Authorized	$21,000,000
Sold	7,022,000
Available	13,978,000
Act of December 17, 1860	
Authorized	$10,000,000
Sold	10,000,000
Available	None
Act of February 8, 1861	
Authorized	$25,000,000
Sold	11,105,000
Available	13,895,000
Act of March 2, 1861	
Authorized	$10,000,000
Sold	4,901,000
Available	5,099,000
Total authorized	$66,000,000
Total sold	33,028,000
Total available	32,972,000

On May 31 an additional $7,310,000 of bonds were sold at prices ranging from 85 to 93. About this time $1,684,000 of notes were disposed of at par. Some additional Treasury notes were taken thereafter, principally by creditors of the government who accepted the 6-per-cent obligations in preference to delay in payment of their accounts.[40] In June the credit of the government had so far deteriorated that the two-year notes sold in the market at a 2½-per-cent discount. Unable under existing authorizations to accept

[38] 12 Statutes 79, 129, and 178, respectively.

[39] Sen. Ex. Doc. No. 2, 37th Cong., 1st Sess., pp. 11-12; Bolles, *Financial History of the United States from 1861 to 1885*, pp. 6-10; Knox, *op. cit.*, pp. 80, 83.

[40] Sen. Ex. Doc. No. 2, 37th Cong., 1st Sess., pp. 11-12.

a price below par, the Treasury then pledged notes as collateral with certain banks for a $5 million 60-day loan.[41] The first actual war loan was not authorized by Congress until July 17, 1861.[42]

The Nature of Prewar Finance

Such was the financial background for a long and costly war. Certain aspects of it are of considerable significance in relation to the nature and trend of Civil War finance. Especially important was the low state to which the public credit had fallen even before the war began. Failure to enact adequate revenue measures had impoverished the Treasury; and as a consequence it was necessary to finance the mounting deficit by borrowing.

Significant too were the proposals for use of special inducements to investors in connection with the sale of government obligations. It was suggested that the public lands be pledged and the proceeds from their sale be applied to the redemption of debt; that certain states endorse the government's obligations so that they might be sold at par; and that the surplus distributed to the states in 1837 should be pledged as security for the government's borrowing. Thus consideration was already being given to ways in which the sale of bonds and notes could be stimulated by provisions other than the price and yield of the obligations and the ability of the government to sustain its credit through adequate revenue measures. In the period to follow, a variety of borrowing devices was employed to facilitate negotiations, to avoid criticism from political opponents and the less perceptive of the public, and to give an appearance of financial strength.[43]

Short-term borrowing was the outstanding feature of government finance at this time. The use of Treasury notes—an easy means of financing, especially at critical times or when the public credit is weak—was both a symptom of the government's financial difficulty and a further cause of it as the notes fell due. The $20 million of one-year notes of 1857 were repeatedly reissued not by reason of necessity but because of Congressional inertia and the

[41] Knox, *op. cit.*, p. 83.

[42] 12 Statutes 259.

[43] It has been well established that the use of special inducements in government borrowing has frequently been detrimental to the public credit and to the national economy and has been at the root of many subsequent problems of government finance. For a definitive study of this aspect of public finance, see Robert A. Love, *Federal Financing* (New York: Columbia University Press, 1931).

inclination of the Secretary to redeem them gradually rather than fund them. Between December, 1860, and July, 1861, when the first war loan was authorized, resort was had repeatedly to the sale of short-term notes; and as the decline in the government's credit continued and the value of the notes depreciated it even became expedient to borrow upon them as collateral.

Secretary Cobb's estimate of the usefulness and the advantages of Treasury notes well in advance of Secretary Chase's elaborate employment of them during the war, the resort to the sale of short-term notes at various times long before his administration,[44] and the use of such notes in the several months just before the war were strong precedents for them in wartime financing. It was soon to be demonstrated on an enormous scale, however, that whatever the advantage of Treasury notes in making the finances of the government more flexible, the employment of them in place of bonds and adequate taxation in financing a costly war was an abuse of the particular form of indebtedness which they represented.

In the *Report of the Secretary of the Treasury*[45] which was submitted to the special session of Congress when it convened July 4, 1861, the status of the public debt was shown as follows:

	March 7, 1861	July 1, 1861
Permanent debt	$59,992,887.64	$70,256,167.04
Treasury notes	16,462,411.64	20,611,661.64
	$76,455,299.28	$90,867,828.68

[44] Between 1837 and 1847 there were numerous instances in which one- and two-year note issues were authorized by Congress. See Bayley, *op. cit.*, pp. 67-75.
[45] Sen. Ex. Doc. No. 2, 37th Cong., 1st Sess., p. 18.

CHAPTER III

Debt Policies of the War

Before turning to the subject of debt management in the post-Civil War period, a general appraisal of wartime debt policies is appropriate. The details of Civil War finance—a study in itself—are, for the most part, passed over here in favor of a broad view of measures and policies which determined the size and character of the debt and many of the subsequent problems of its management.

Neither Secretary Chase nor the President foresaw a long war. For nearly a generation no grave and long-continued questions of public finance had stimulated general discussion or called forth and clothed with experience the ablest financiers. The national traits of optimism and "Yankee ingenuity," as well as lack of any widespread understanding of the nature of money and credit, must have fortified strongly the inclination to finance the war along those lines which, speciously, seemed easiest and least expensive. The ruinous lessons of eighteenth-century European finance and of American finance in the Revolution were apparently forgotten. The experience of the government as recently as the War of 1812—that resort to excessive issues of Treasury notes[1] and failure to enact adequate revenue measures would have led to disaster had that war continued—was overlooked.

The first great war-loan enactments and the way in which they were administered set the tone for further borrowing as the war progressed. Following the report of the Secretary of the Treasury,

[1] See, for example, *The Bankers' Magazine and Statistical Register,* XIX (Aug. 1864), 81-82; and Albert Bushnell Hart, *Salmon Portland Chase* (Boston: Houghton Mifflin Co., n.d.), p. 242. "The policy of carrying on a war by means of credit was adopted in the United States in 1812 and again in 1861, and in both cases proved to be weak and inefficient" (Henry Carter Adams, *The Science of Finance: An Investigation of Public Expenditures and Public Revenues,* New York: Henry Holt & Co., 1898, p. 536).

made on July 4, 1861,[2] to the special session of Congress, the loan measures of July 17 and August 5 were passed.[3] These acts were closely in accordance with suggestions made by the Secretary. He was authorized to issue up to 250 million in three-year 7.3-per-cent Treasury notes or in twenty-year bonds with interest not exceeding 7 per cent. The three-year notes were made exchangeable at any time for twenty-year 6-per-cent bonds. It was also provided that $50 million of the total amount authorized might take the form either of non-interest-bearing Treasury notes, in denominations of from $5 to $50, payable on demand and receivable for all public dues, or of 3.65-per-cent notes, payable in one year, and fundable into Treasury notes with denominations above $50. Also in accordance with a proposal by the Secretary, $100 million of the bonds authorized by the act of July 17 might be negotiated in Europe.[4]

Before giving consideration to the manner in which a considerable part of the loan was placed, and the circumstances attending the transaction, two significant expressions of financial policy should be noted. Both of them appeared in the Secretary's recommendations to Congress, and both were adopted by that body in the above-mentioned enactments.

Efforts to Obtain Funds in Europe

The first of these was the provision that $100 million of the bonds authorized could be sold in Europe. That financial aid from Europe, especially England, did not materialize is not proof that this provision in the loan authorization was merely a fond hope. In the summer of 1861 it was scarcely foreseen that specie payments by the banks would be suspended at the year's end to be followed immediately after by the suspension of such payments at the Treasury with serious injury to both public and private credit. The *Trent* affair, which became known late in the year, had not yet crystallized English sentiment against the Union. Although, in 1861, both the London *Times* and the London *Economist* saw small chance for victory by the Union, and though the English aristocracy heartily favored the cause of the South, the majority of the English people appear to have been more hostile to the South than to the

[2] Sen. Ex. Doc. No. 2, 37th Cong., 1st Sess.
[3] 12 Statutes 259, 313.
[4] 12 Statutes 259.

North.[5] Slavery as an institution was generally disapproved in England.[6]

Professor Barrett points out that some small purchases of the 7.3-per-cent Treasury notes were actually made about that time by Europeans, and that in September the house of Barings stated that English people would be quite willing to take a part of the loan being assumed by the American banks.[7] He adds that although adequate proof is lacking, reports were current in October and November that English interests had made the proposal to Secretary Chase that they would take $100 million at 6½ per cent.[8] Thus it appears that during the few months before the *Trent* affair, and in the few months after its adjustment, but particularly during the former period—the autumn of 1861—the Union might have placed loans in England, although undoubtedly at considerable discount. In the spring of 1862 English sentiment had become more favorable, but later in the year it again deteriorated.[9]

In 1863 Secretary Chase induced Robert J. Walker, who had held the Treasury portfolio under Polk, to serve as a special revenue agent in Europe. His efforts there, particularly in England, in 1863 and 1864, did not yield immediate, tangible results. He was more the press agent and propagandist extraordinary, his object being to damage the credit of the South and enhance that of the North through the written and spoken word. Two representatives of the Navy Department, Aspinwall and Forbes, were sent to London in the spring of 1863 to negotiate a loan with Barings, the proceeds to be used in preventing the sale of certain war vessels to the Confederacy. Having little success, they returned within a few months.[10]

[5] An analysis of the English attitude toward American loans during the first year of the war is given in Barrett, *The Greenbacks*, pp. 41-44.

[6] See Robert J. Walker, *American Slavery and Finances* (3d ed.; London: William Ridgway, 1864).

[7] Barrett, *op. cit.*, p. 42. He cites the Boston *Advertiser*, Sept. 16 and Nov. 25, 1861.

[8] *Ibid.* He cites the Boston *Advertiser*, Oct. 21 and 22, 1861; the New York *Journal of Commerce*, Nov. 15 and 16, 1861; and the London *Spectator*, Nov. 2, 1861.

[9] *Ibid.*, pp. 43-44.

[10] ". . . neither Chase nor Walker considered an immediate loan the most important objective. The immediate exigency was to strike a damaging blow at the credit of the South." See Amos E. Taylor, "Walker's Financial Mission to London on Behalf of the North, 1863-1864," *Journal of Economic and Business History*, III (Feb., 1931), 301-304, 311.

It was in the latter half of 1863 that Jay Cooke, acting as special agent of the Treasury, conducted the highly successful campaign for popular subscriptions to nearly $500 million of the five-twenties. While this sale of the bonds was in progress he was urged repeatedly, both by his brother Henry—a partner in his firm—and by others, to attempt the sale of a substantial block of the securities in European markets, "but he resisted all the importunities of such advisors on patriotic principles."[11] Some expressions of interest were being received from English investors; and in February, 1864, small shipments of bonds were sent to William Evans, a banker there, by Jay Cooke and Company.[12] With regard to this sale of a small quantity of bonds in England at that time Jay Cooke's biographer states:

> . . . the incident, unproductive as it was of large results, is indicative of what Mr. Cooke could and would have done by an application of his methods in foreign countries, if he had not succeeded in distributing the loans at home. The premium on gold was such that the 5-20s were sold in England at this time from $60 to $65 for a $100 bond.[13]

The failure to obtain funds in Europe, even if at a great discount, was certainly unfortunate, and may, perhaps, be ascribed to "the absence of proper financial management."[14] But popular approval of such financiering, no matter how urgent the need, was hardly to be anticipated. The two wars with England were not forgotten in the public mind;[15] and the democratic dislike of English ways and manners was strong among the rural and frontier populations.[16] No doubt many would have felt, however illogically, that national pride and dignity had been injured were Federal bonds cheaply sold in a foreign market. Secretary Chase, far more a politician than a financier, may well have sensed beforehand the sentiment of the people when he failed to press vigorously the sale of United States bonds in Europe.

[11] Ellis Paxon Oberholtzer, *Jay Cooke, Financier of the Civil War* (Philadelphia: George W. Jacobs & Co., 1907), I, 285-286.

[12] *Ibid.*, pp. 288-289.

[13] *Ibid.*, p. 289.

[14] Barrett, *op. cit.*, p. 44.

[15] James G. Blaine, *Twenty Years of Congress: From Lincoln to Garfield* (Norwich, Conn.: The Henry Bill Publishing Co., 1884-1886), II, 483-485.

[16] Such hostility appears to have been much less evident in New England, especially among the more educated, than elsewhere. See Van Wyck Brooks, *The Flowering of New England, 1815-1865* (rev. ed.; New York: E. P. Dutton & Co., Inc., 1940), *passim.*

This same notion, that national dignity was lowered if loans were offered below par,[17] even within the country, found expression in the legal-tender controversy. In their essay, "The Legal Tender Act," Francis A. Walker and Henry Adams recognized the part this view played in encouraging resort to the issue of greenbacks, and they emphasized the fallacy of it.[18] Even Secretary Fessenden, before the war had ended, was to point out that the country had not had to appeal for aid to any foreign people, that it had demonstrated its own power and ability to put down insurrection. "The people of the United States have felt a just pride in this position before the world."[19]

Thus, the plan to borrow in Europe a part of the cost of the war was proposed by Chase, authorized by Congress, and anticipated by American bankers and by many of the people, yet it was not followed out—despite considerable evidence that at certain times such borrowing was feasible[20] (though politically inexpedient).

Inconsistency in Interest-Rate Policy

Another policy in connection with this first large loan authorization of the war favored a relatively high rate of interest. (This policy, also, was proposed by Chase[21] and authorized by Congress.[22]) The first loan act provided for the issue of as much as $250 million in three-year 7.3-per-cent Treasury notes or twenty-year bonds with interest not exceeding 7 per cent.[23] These were realistic interest rates; and from the comments of the Secretary regarding them it would seem that his later unwise and stubborn[24]

[17] See, for example, Blaine, *op. cit.*, II, 325.

[18] In *Chapters of Erie, and Other Essays* (Boston: James R. Osgood & Co., 1871), pp. 331-332. "In order to protect the nation's credit from degradation in the hands of bankers and brokers, the government undertook to dishonor it of its own free will."

[19] *Treasury Report,* 1864, p. 17.

[20] Barrett, *op. cit.*, pp. 42 *et seq.*

[21] Sen. Ex. Doc. No. 2, 37th Cong., 1st Sess., pp. 12-13.

[22] 12 Statutes 259, 313.

[23] Act of July 17, 1861 (12 Statutes 259). The supplementary loan legislation, Act of Aug. 5, 1861 (12 Statutes 313), made the three-year 7.3-per-cent notes exchangeable for twenty-year bonds bearing 6-per-cent interest.

[24] This becomes apparent as one follows the course of Secretary Chase's policies, and it is concurred in by many writers on the subject. See, for example, Elbridge G. Spaulding, *History of the Legal Tender Paper Money Issued during the Great Rebellion* (2d ed.; Buffalo, N. Y.: Express Printing Co., 1869), pp. 1-11; Bolles, *Financial History, 1861-1885,* pp. 97-98 and 103-111; Dewey, *Financial History,* pp. 307-309; Barrett, *op cit.*, pp. 32-33; Love, *Federal Financing,* pp. 76-77; and William J. Shultz and M. R. Caine, *Financial Development of the United States* (New York: Prentice-Hall, Inc., 1937), pp. 300-301.

determination to borrow at succeedingly lower rates had not yet been formed. In his report to the special session of Congress, July 4, 1861, he stated, in urging the 7.3-per-cent rate of interest:

> The interest of seven and three-tenths is suggested, because it is liberal to the subscriber, convenient for calculation, and, under existing circumstances, a fair rate for the government.
>
> It is beneficial to the whole people that a loan distributed among themselves should be so advantageous to the takers as to inspire satisfaction and hopes of profit rather than annoyance and fears of loss; and, if the rate of interest proposed be somewhat higher than that allowed in ordinary times, it will not be grudged to the subscribers when it is remembered that the interest on the loan will go into the channels of home circulation, and is to reward those who come forward in the hour of peril to place their means at the disposal of their country.[25]

Yet as the war continued Chase took great pride in achieving lower rates of interest on succeeding loans.[26] Nor would he consent to sell bonds at what they would bring on the market when too low an interest rate made them unattractive for public subscription. He seems not to have realized that the Treasury actually was selling its bonds at a very great discount in terms of the depreciating greenbacks paid for them. Although the first loan was sold at 7.3 per cent, succeeding loans bore rates of 7, 6, and 5 per cent. The large amounts of United States notes and fractional currency, of course, bore no interest. He was proud of what he regarded as his achievement in maintaining low interest rates on the debt.[27] Apparently he failed to perceive the relation of his policies to the nearly disastrous state into which the Treasury had fallen.

Here again was an instance in which a particular policy,[28] determined upon and urged, was reversed and the reversal stubbornly adhered to, to the detriment of the country's finances and Chase's reputation as a financier among those who understood such

[25] Sen. Ex. Doc. No. 2, 37th Cong., 1st Sess., pp. 12-13.

[26] *Treasury Report*, 1863, p. 13.

[27] *Ibid.*

[28] Bolles says of this policy of Chase: "A financier never lived disliking a financial system or policy so strongly as Mr. Chase, who, nevertheless, so persistently followed it, and who with equal persistence continued to take those steps which would compel him to follow it. He forced himself into the trap, and was continually weaving the web tighter, thus making release more and more difficult. A sadder example of financial helplessness has been rarely seen" (*op. cit.*, p. 98).

matters.[29] This pattern was repeated, as will be shown further on, in other important instances in which the Secretary dominated.

Debt Policy and the Suspension of Specie Payments

The first actual war loan was authorized in the acts of July 17 and August 5, referred to previously. Under these authorizations the issue of $150 million 7.3-per-cent three-year Treasury notes was undertaken. Although the loan was opened to public subscription, it was underwritten by certain eastern banks which were committed to advance instalments of $50 million at two-month intervals, reimbursement to be made to them by the Treasury as public subscriptions were received. Only $45 million of the first instalment could be sold, and the banks took the remainder as well as all of the second instalment hoping to dispose of them to their customers. In place of the third instalment the banks took 6-per-cent long-term bonds at a price to yield 7 per cent.[30]

In connection with this sale of Treasury notes there developed another financial policy of the Secretary which was to have far-reaching consequences. He insisted that the notes underwritten by the banks be paid for in specie. Chase considered himself a "hard money" man; and he did not relish the prospect of accepting bank notes at the Treasury. Especially in the western part of the country the note issues of some banks were not well secured.[31] The tradition of the Independent Treasury system was fixed firmly in his mind. It has been suggested that his plan for a national banking system may have contributed to his opposition to the increase in state-bank-note circulation which would have resulted had media other than specie been acceptable.[32] However this may have been, it is evident that he did not comprehend the magnitude of the transaction in terms of the specie available; nor did he see that to draw specie from the banks and disburse it about the country in a time of fear and insecurity would weaken the foundation of the whole banking structure.[33] He seemed unaware of the mechanism

[29] See Love, *op. cit.*, pp. 76-77; and *Bankers' Magazine*, XIX (Aug., 1864), 81-82.

[30] *Cf.* Barrett, *op. cit.*, p. 9; Shultz and Caine, *op. cit.*, pp. 294-295.

[31] This would be particularly the case where a part of the securities held for note redemption were the depreciated bonds of Southern States. See Bolles, *op. cit.*, pp. 28-29.

[32] Shultz and Caine, *op cit.*, p. 295.

[33] "Of the two evils, acceptance of bank-notes in payment of government dues

of the banking system whereby, through the use of bills of exchange, certificates of deposit, drafts, checks, and notes, a very large volume of business was transacted daily.[34]

It is the more remarkable that he unyieldingly demanded payment in specie, not only contrary to the earnest urging and advice of the most able bankers in the country,[35] but contrary, too, to a definite provision in the Act of August 5, 1861,[36] which had been specifically included to free him from the Independent Treasury law, which required that only coin be accepted as payment to the government.[37]

The first material mistake in the management of the finances, occurred when Secretary Chase discarded the use of the bank check, and the clearing house, in the fall of 1861. The Secretary of War might, with the same propriety, have rejected the railroad, the locomotive, and the telegraph.[38]

Another policy, which in conjunction with the foregoing could only have been harmful, was the issue of demand notes (later referred to as "old demand notes"). These had been authorized by the Loan Act of July 17, 1861, to the extent of $50 million, in denominations of less than $50, to bear no interest, and to be reissuable.[39] In fact, by this authorization precedent was set for the circulation of Treasury notes as paper money.[40] They were issued during the same period that the $150 million of three-year Treasury

and the suspension of specie payments, the first, of course, was infinitely the less. The mistake of Secretary Chase was in thinking he could avoid both." See David Kinley, *The History, Organization and Influence of the Independent Treasury of the United States* (New York: Thomas Y. Crowell & Co., 1893), p. 67.

[34] "Were not payments to the amount of twenty millions daily effected in New York City without coin and notes? The daily settlement of an additional million or so of government indebtedness could have been easily and safely effected by employing the same machinery" (Bolles, *op. cit.*, pp. 38-39).

[35] See Barrett, *op. cit.*, pp. 9, 13-14; Bolles, *op. cit.*, pp. 40-41.

[36] 12 Statutes 313. The wording of the act clearly indicates that payment received from the sale of bonds might be credited to the account of the Treasury by the banks. Section 6 suspends the provision of the Independent Treasury Act of 1846 "so far as to allow the Secretary of the Treasury to deposit any of the moneys obtained on any of the loans now authorized by law, to the credit of the Treasurer of the United States, in such solvent specie-paying banks as he may select . . . ."

[37] Spaulding, *op. cit.*, pp. 1-4. See also Mitchell, *History of the Greenbacks*, pp. 25-26.

[38] Spaulding, *op. cit.*, p. 1.

[39] 12 Statutes 259.

[40] See Barrett, *op. cit.*, p. 5; and Sherman, *Recollections*, I, 259: "The first feeble attempt to create a national currency was the issue of demand notes . . . ."

notes was being unsuccessfully underwritten by the banks, and were strongly objected to by the banks on the ground that as a result of any very large circulation of them the banks would "receive less gold in their daily business transactions, and thus would be less able to fulfill their loan agreement with the government."[41]

That these two policies contributed to the financial crisis and the necessity for the suspension of specie payments by the banks late in December of 1861 seems apparent. The bankers of the country placed the blame entirely upon the Treasury. Yet the underlying causes were larger than these. Public confidence was at a low ebb; the war was not going well for the North; the *Trent* affair threatened trouble with England; no adequate tax legislation had been undertaken to bolster the public credit; and specie was gradually being drained from the banks to be hoarded.[42]

The Legal-Tender Acts and the National-Banking Acts as Expressions of Debt Policy

The issue of United States notes (greenbacks) during the war was a departure from orthodox financing induced by the suspension of specie payments and the confused and panicky thinking of statesmen following the outbreak of the war. These notes were to have a profound influence upon the price level, the cost of the war, the future course of borrowing, and the ultimate size of the debt. They served as a form of money; and as one issue followed another they depreciated rapidly. It was only after this depreciation that the people were inclined to invest in the government's bonds. At the outset the greenbacks had been regarded by the government as a form of debt which in time would be converted into long-term obligations. Instead of providing for their redemption at a given date Congress made them convertible at any time, at the option of the holder, into 6-per-cent five-twenty bonds.[43]

Had this provision for their conversion been retained, the greenback notes would eventually have been funded, and there would have been no later problem concerned with the resumption of payment of them in specie. Unfortunately the right to exchange them for bonds was abrogated, and the privilege terminated on July 1, 1863.[44] To many this was a "breach of public faith."[45] It changed

[41] Dewey, *op. cit.*, pp. 279-280.
[42] *Ibid.*, pp. 281-283.
[43] 12 Statutes 345, 532, 710, 822.
[44] Act of March 3, 1863, 12 Statutes 710.
[45] Bolles, *op. cit.*, p. 109.

fundamentally the nature of the notes,[46] and made the return to specie payments a slow and painful process.[47]

The United States notes, circulating as money, were in effect a forced loan upon the people. They bore no interest and had no redemption date. Many were issued in small denominations. They were, by law, tenderable for payment of all public and private debt within the country, except duties on imports and interest on the public debt. The notes were, in fact, printing-press money, and as such their value in terms of gold quickly depreciated. On June 30, 1864, when the wartime emission of them ceased, $431 million were outstanding.

For many years the greenbacks were to be a subject of controversy, and the magnitude of their influence upon the financial life of the country and upon the public credit at certain critical times was to be very great.[48] Their relation to, and their influence upon, the debt-management policies of the government appear throughout this study.

The introduction of a national-bank-note currency had a salutary effect upon the monetary situation, for it helped to stop the further issuance of greenbacks. In a way, however, the excessive supply of the latter form of currency facilitated the great reform of the banking and currency system which found expression in the National Banking Acts of February 25, 1863, and June 3, 1864.[49] This reform was Secretary Chase's great achievement.

There was real need for a national currency.[50] It was thought that through their policy of increased circulation and loans the state banks had made the volume of currency in the country excessive. Extreme expansion and contraction of bank issues in the past had

[46] See, for example, Knox, *op. cit.*, p. 138; and Spaulding, *op. cit.*, pp. 8-9.

[47] "No measure for resuming specie payments possessing higher merit was ever devised. In a thoughtless hour it was repealed. Congress, though, when doing this, did not realize the potency of the measure for restoring the specie standard of payment. All were thinking of the anxious present, and leaving the future for others" (Bolles, *op. cit.*, p. 110). See also Knox, who says, "By this repeal, they were made a permanent circulation" (*op. cit.*, p. vi).

[48] Much has been written on the subject of the greenbacks. Among the best works are those of Mitchell, Barrett, Bolles, Newcomb, Knox, Walker and Adams, Hepburn, and McCulloch (in certain parts of his *Treasury Reports* for the years 1865-1868).

[49] 12 Statutes 665; 13 Statutes 99.

[50] "All told, about 7,000 different kinds of notes circulated, to say nothing of successful counterfeits . . . . In 1862 only 253 banks issued notes which had not been altered or imitated" (Dewey, *op. cit.*, p. 322).

led to the belief that such elasticity was undesirable. Many of the state banks were not co-operating with the government in the financing of the war. It was believed that a national banking system would do much to bolster the public credit, as well as to provide depositories for a part of the public monies. Secretary Chase saw it also as an aid to the return to specie payments.[51] Especially important was the market for government bonds which the banks would afford. Chase estimated that $250 million would be needed to secure their circulation. With popular opinion opposed to the state banks, and with the President's approval supporting the plan, the national banking bill duly became a law.

The Sale of Bonds at Par for Greenbacks

Secretary Chase's insistence upon selling bonds at par while maintaining a low rate of interest on them had at first made the war bonds unattractive to investors and had obliged him to resort to repeated issues of short-term, legal-tender, and non-interest-bearing obligations. But as the greenback portion of the debt depreciated, the government's bonds, payable principal and interest in gold, could be sold at par for the greenbacks. The extreme depreciation of the currency and of the government's credit seems not to have been effectively comprehended by a large part of the population, from whom it was concealed, in a way, by the general use of the paper notes popularly regarded as money.

> . . . at the very time when the premium on gold over paper was approximating (or in excess of) 100, the public were gravely congratulated, both in Congress and through the press, that the treasury had not been forced to the necessity of issuing any of its bonds to subscribers at a price below par . . . .[52]

The cost of the war was increased at least $500 million by use of the rapidly depreciating legal-tender greenbacks.[53] The extravagant method which both Congress and the Secretary deemed it necessary to employ has been aptly summarized by two informed contemporary observers:

[51] " . . . it is the Secretary's firm belief that by no other path can the resumption of specie payments be so surely reached and so certainly maintained" (*Treasury Report,* 1862, p. 21).

[52] David A. Wells, *The Recent Financial, Industrial, and Commercial Experiences of the United States.* (New York: J. H. and C. M. Goodsell, 1872), p. 15.

[53] See page 10, above.

The government, adhering to the policy of selling its bonds only at par, was obliged to consider its paper as the par standard, and the next step was to issue of its own accord enough paper to "float" the successive loans. This was equivalent to selling its credit at the market price, with the addition of voluntarily degrading its own standard of value.[54]

Sources of Debt Policy

The very great influence of a few men, and of one in particular—Secretary Chase—in the formulation and execution of the debt policies of this period must be apparent. It is clear too that many of the policies were premised upon false assumptions or upon considerations of expediency.[55] Not much time was to elapse before it became evident that such policies were highly disadvantageous to the Treasury, uneconomical, disturbing to the national economy, and harmful to the public credit.

Several such policies have already been indicated. Much of the same pattern was repeated in other important instances in which Chase dominated. His vacillations on the principle of legal tender are well known to the student of finance.[56] When Congress authorized him to sell bonds at their "market value," which plainly meant at the best price they could bring, even if below par, Secretary Chase insisted that "market value" meant "par value" and therefore the bonds could not be sold. This led to the issue of more greenbacks, for large sums were urgently due the Army and Navy. Fixing the rate of interest at 5 per cent instead of 6 on the bonds offered in the spring of 1864 was an unfortunate attempt at economy, for the market for government bonds then indicated the need for a higher rate to make the issue an attractive investment. Sale of the bonds fell far short of requirements, and the Treasury was obliged to rely further upon a variety of short-term forms of indebtedness to meet the demands being made upon it.

Even his last official act as Secretary was an attempt to establish

[54] Francis A. Walker and Henry Adams, "The Legal-Tender Act," in *Chapters of Erie, and Other Essays*, p. 331.

[55] A contemporary student of political economy remarked on "the general disposition manifested in our legislative halls and our organs of public opinion, to ignore all that the nineteenth century has done for financial science, and to adhere entirely to the views and practices of the eighteenth" (Simon Newcomb, *A Critical Examination of Our Financial Policy During the Southern Rebellion*, New York: D. Appleton & Co., 1865, p. 4).

[56] In his varying loyalty to the President may also be seen some of the same compulsions. See page 35, below.

a policy which was utterly unrealistic and unworkable. In a letter to Horace Greeley, later published in the New York *Daily Tribune*,[57] he had written, "The price of gold must and shall come down, or I'll quit and let somebody else try." Just before this, on June 17, 1864, Congress had passed a bill prepared by him that aimed to prevent all dealing in gold except when the actual metal was sold by its possessor and delivered on the same day. He did not understand that his own Treasury policies, and not the activity of speculators, was the cause of the rise in gold in terms of depreciating greenbacks. Within two weeks gold advanced from 195 to 285, making the value of the paper dollar 35 cents in terms of gold. Congress hastily reversed this policy of the former[58] Secretary by repealing the act on July 2.

During this period of national finance the bankers had little to do with the formulation of debt policies. The Secretary ignored their advice and apparently distrusted them. They blamed him for failure to propose adequate tax legislation at the beginning of the war, and for the substitution of paper money in place of taxes.[59] James Gallatin, prominent banker and financial authority of the period, wrote of Chase and the greenback policy:

> . . . it is evident, that in the multiplicity of his engagements, he has had forced upon his attention, and become mentally confused by, those destructive and revolutionary theories of currency, which the disciples of the famous JOHN LAW have been disseminating in both hemispheres during a century and a quarter. Such theories have been fruitful of great popular delusions in nations; and among legislators as well as statesmen . . . .[60]

His policies had destroyed the good feeling between the bankers and the government, and they welcomed his resignation.[61]

[57] Jan. 20, 1895.

[58] He had resigned on June 30, 1864, for reasons not connected with this incident.

[59] "At a moderate computation the government has paid five hundred millions of dollars more on its army and navy contracts than would have been paid with a financial policy more consistent and more sound" (*Bankers' Magazine*, XIX, Aug. 1864, 82).

[60] "Letter to Hon. Samuel Hooper, of Massachusetts, Member of the Committee of Ways and Means of the United States House of Representatives, from James Gallatin, Esq., of New York" (reprint from New York *Commercial Advertiser* of Dec. 20, 1862), p. 5.

[61] "The announcement was hailed with satisfaction by the people and the press generally; the management of the public finances indicated a want of foresight and sagacity as to the ways and means of the government" (*Bankers' Magazine*, XIX, Aug,. 1864, 81).

The powers of the Secretary of the Treasury were, of course, limited by the will of Congress.[62] To an unusual extent, however, the 37th and 38th Congresses relied upon the recommendations of Secretary Chase, and much of their financial legislation was enacted in accordance with his policies.[63] Few members of Congress were even slightly experienced in matters of finance. Ignorance, probably, rather than lack of principle, made possible the passage of the Legal-Tender Act. Walker and Adams say of it:

> The good sense and high moral standard of a few men served only to relieve and make more conspicuous the dark and impenetrable cloud of ignorance against which their efforts were utterly thrown away.[64]

In the House, Thaddeus Stevens[65] was chairman of the Committee on Ways and Means. Though untrained in matters of finance, he exerted much influence on the framing of financial measures. Justin S. Morrill was chairman of a House subcommittee on taxation. He was a practical man and experienced in matters of taxation. In the earlier part of the war borrowing rather than taxation was the policy, and, as a consequence, his abilities at that time served but little. Elbridge G. Spaulding, chairman of a subcommittee on loans and currency, had had some experience in banking but appears to have been less a financier than a politician.[66] The two other members of Spaulding's subcommittee were Samuel Hooper and Erastus Corning. Hooper had some reputation as an authority on money,[67] and at this time he was re-

[62] "It is not too much to say that the Secretary of the Treasury can exercise no constitutional influence upon fiscal legislation" (Adams, *Science of Finance*, p. 124).

[63] "Chase was the guiding spirit of the fiscal affairs of the Nation. Never before nor since had a finance minister wielded such power as was placed in his hands" (A. Barton Hepburn, *History of Coinage and Currency in the United States*, New York: The Macmillan Co., 1903, p. 198).

[64] *Op. cit.*, p. 322.

[65] Of him Walker and Adams wrote: "That Mr. Stevens was grossly ignorant upon all economical subjects and principles was the least of his deficiencies. A dogmatic mind, a high temper, and an overbearing will are three serious disqualifications, for financial success, especially when combined with contempt for financial knowledge" (*op. cit.*, p. 307).

[66] He had served as Treasurer of the State of New York, and at one time had managed a bank in the city of Buffalo (*ibid.*). John Sherman, in his *Recollections*, praised Spaulding for his part in dealing with the financial problems of the time. He mentioned Stevens with considerable respect, referring to him as "one of the most remarkable men of the last generation" (I, 192-196, 271-273).

[67] He believed in restricting the power of banks to issue notes and in requiring the deposit of adequate security for such issues. He emphasized that gold and silver constituted "the only *real money* of commercial nations." See Samuel Hooper, *Currency or Money, Its Nature and Use* (Boston: Little, Brown & Co., 1855), pp. 5-7.

garded as conservative in his monetary views.[68] Yet it developed that he was quite willing to endorse the use of paper money in "great emergencies" and to defend its issue.[69] William P. Fessenden, an able lawyer and conscientious legislator, was chairman of the Senate Committee on Finance.

President Lincoln was not skilled in matters of finance, and, like Chase, at the outset of the war he did not anticipate its long continuation. Neither the President nor his cabinet realized how enormous would be the financial strain on the government. His messages and official papers make only limited comment with regard to the financing of the war. In his first annual message to Congress, December 3, 1861, the President stated:

> The operations of the Treasury . . . have been conducted with signal success. The patriotism of the people has placed at the disposal of the Government the large means demanded by the public exigencies.[70]

In his second annual message he referred to the large issue of United States notes as being unavoidable, and said:

> In no other way could the payment of the troops and the satisfaction of other just demands be so economically or so well provided for . . . . A return to specie payments, however, at the earliest period compatible with due regard to all interests concerned should ever be kept in view. Fluctuations in the value of currency are always injurious, and to reduce these fluctuations to the lowest possible point will always be a leading purpose in wise legislation.[71]

In this message he also recommended that the organization of banking associations be permitted under a general act of Congress and that the circulation of such organizations should be secured by the pledge of United States bonds[72]

Upon signing the joint resolution[73] which authorized the Secretary of the Treasury to issue another $100 million in United States

[68] In correspondence with him James Gallatin said of his writings that they "enunciated principles of finance that commend themselves to all persons intimately acquainted with the subject." He referred to Hooper's book as "that admirable work" ("Letter to Hon. Samuel Hooper . . . from James Gallatin, Esq.," cited above).

[69] Barrett, *op. cit.*, pp. 26-27.

[70] James D. Richardson, *A Compilation of the Messages and Papers of the Presidents, 1789-1897* (Washington: Government Printing Office, 1896-1899), VI, 47.

[71] *Ibid.*, VI, 129.

[72] *Ibid.*, VI, 130.

[73] 12 Statutes 822.

notes needed for payment of the Army and Navy, he sent a message to Congress, January 17, 1863, expressing regret that it was necessary to authorize so large an additional issue. He stated:

> It seems very plain that continued issues of United States notes without any check to the issues of suspended banks and without adequate provision for the raising of money by loans and for funding the issues so as to keep them within due limits must soon produce disastrous consequences; and this matter appears to me so important that I feel bound to avail myself of this occasion to ask the special attention of Congress to it.[74]

He then repeated the suggestion made in the preceding annual message that an act of Congress be passed to permit the organization of banking associations which would secure their circulation by the pledge of United States bonds.[75]

In his third annual message, December 8, 1863, he stated that the operations of the Treasury had been successfully conducted. He commented also on the enactment of the National Banking law and the resulting valuable support to the public credit.[76] In his fourth annual message, December 6, 1864, the President said: "The financial affairs of the Government have been successfully administered during the last year."[77] He then commented on the nature of the debt and made a novel proposal:

> Held, as it is, for the most part by our own people, it has become a substantial branch of national, though private, property. For obvious reasons the more nearly this property can be distributed among all the people the better . . . . I suggest whether it might not be both competent and expedient for Congress to provide that a limited amount of some future issue of public securities might be held by any *bona fide* purchaser exempt from taxation and from seizure for debt, under such restrictions and limitations as might be necessary to guard against abuse of so important a privilege . . . . The great advantage of citizens being creditors as well as debtors with relation to the public debt is obvious. Men readily perceive that they can not be much oppressed by a debt which they owe to themselves.[78]

It seems plain that the President concurred, in general, in the

[74] Richardson, *op. cit.*, VI, 149.
[75] *Ibid.*, VI, 150.
[76] *Ibid.*, VI, 183.
[77] *Ibid.*, VI, 246-247.
[78] *Ibid.*, VI, 247-248.

Secretary's policies, leaving the management of the Treasury Department to him. Until, to Chase's surprise, Lincoln accepted his resignation, he had regarded himself as indispensable to the administration.[79] He could hardly have maintained this illusion of indispensability if there had been any serious disagreement between himself and the President with regard to his Treasury policies.[80]

Not always were the debt policies of Secretary Chase unhesitatingly concurred in by Congress, although many measures were enacted at his behest. He was in no way a lobbyist, and he had "few personal friends in either house and fewer spokesmen.[81] He was acknowledged and respected as a man of intellect and power, and both his probity and his patriotism were well recognized.[82] Yet certain of his policies differed widely from those of Congress, as can be seen in his willful interpretation of those enactments the plain reading of which was not in accordance with his wishes. One might gain the impression from his biographer that he was continually at odds with the legislative branch of the government,[83] but this was evidently not the case. In most important instances legislation was enacted to implement his policies; in other important instances (when his wishes were contravened) he overlooked or overrode the expressed policies of Congress.[84] In general, with respect to the creation and the management of the debt during his term of office, the conceptions of Secretary Chase became the policies of the government.[85]

Secretary Chase's "Objectives"

In his report to Congress, in December, 1863, Secretary Chase stated the objectives of his debt policy:

[79] Barrett, *op. cit.*, pp. 70, 110.

[80] Chase aspired to the presidency, and he had permitted his name to be used in opposition to that of his chief. McCulloch says of this: "The acknowledged cause of his resignation was a disagreement between the President and himself in regard to the appointment of a successor to Mr. Cisco in the office of Assistant Treasurer at New York. The real cause was the interruption of their pleasant relations by political rivalry. Mr. Chase's resignation was promptly accepted—I think to his surprise, I am sure to his lasting regret" (Hugh McCulloch, *Men and Measures of Half a Century*, New York: Charles Scribner's Sons, 1888, p. 186).

[81] Hart, *op. cit.*, p. 235. [82] *Ibid., passim.*

[83] " . . . he never could bring Congress to accept his financial scheme in an entirety, or any part of it without great modification of details" (*ibid.*, p. 235).

[84] See above; and also Spaulding, *op. cit.*, pp. 1-11.

[85] The legal-tender idea, which developed into a policy of far-reaching importance, was a major exception. It did not originate with Chase, although he approved of it, at first reluctantly, on the grounds of necessity and fairness to all the people (Bolles, *op. cit.*, pp. 51, 54-55: see also Sherman, *op. cit.*, I, 274).

In the creation of debt, by negotiation of loans or otherwise, the Secretary has kept four objects steadily in view: (1) moderate interest; (2) general distribution; (3) future controllability; and (4) incidental utility.[86]

The average rate of interest on the total amount of debt had indeed declined and was certainly at a low level, but it was artificially so:

> . . . the average rate is now increasing, and it is obvious that it must continue to increase with the increase of the proportion of the interest-bearing to the non-interest-bearing debt. And as the amount of the latter, consisting of United States notes and fractional currency, cannot be materially augmented without evil consequences of the most serious character, the rate of interest must increase with the debt, and approach continually the highest average.[87]

This average rate varied as follows:[88]

July 1, 1862	4.36
January 1, 1863	4.02
July 1, 1863	3.77
October 1, 1863	3.95

Much of the widespread distribution of the debt was a consequence of the forms in which it had been created. The United States notes and fractional currency bore no interest and circulated as media of exchange. Certificates of indebtedness had been distributed among a host of contract creditors and temporary depositors. Popular subscription to bonds had also broadened the distribution of the debt.[89]

To Chase the term "controllability" gave virtue to a debt structure which had developed as a result of his policies. He did not recognize that there was controllability in one respect and serious lack of it in others. When he stated that the debt was "in such a shape that prompt advantage can be taken of favorable circumstances to diminish the burdens it imposes on industry,"[90] he said nothing of the hazards which so great an amount of very short-term obligations might present to the Treasury in the event of

[86] *Treasury Report*, 1863, p. 13.
[87] *Ibid.*
[88] *Ibid.*
[89] *Ibid.*, pp. 13-14.
[90] *Ibid.*, p. 15.

diminishing revenues or a financial stringency.[91] He was satisfied that the nature of the debt would permit large-scale funding under favorable conditions, and in pointing this out concluded that "Nothing further seems desirable on the score of controllability."[92]

As for incidental utility, he cited the advantage of the temporary deposits, against which business might draw in time of stringency; the utility of having a large part of the debt adapted to circulate as money; the national unity which results when all the people share in the ownership of the debt; and the advantages of a national banking currency secured by a part of the national debt.[93]

It is to be noted that these objectives were not formally stated until his report to Congress was made in December, 1863. The war was then well along in its third year. As Chase described them, the objectives fitted perfectly the debt situation as it then existed. His detailed discussion of them was actually an elaborate attempt to justify the debt structure which had evolved under his direction. These objectives, as he defined them, and as the preceding part of this study indicates, were not all a part of an original policy, nor had he kept them all "steadily in view." He was making a virtue of what, at times, had seemed to him necessity. Convinced of the greatness of his achievement by his own arguments, he concluded the discussion of his four objectives with unwitting irony:

> In these several ways may even such great evils as are brought upon us by rebellion be transmuted, by a wise alchemy, into various forms of utility. The Secretary has endeavored to use this alchemy; with what success the country will judge when time and trial shall have applied to his work their unfailing tests.[94]

The Policies of Secretary Fessenden

William Pitt Fessenden, during his brief term as Secretary of the Treasury,[95] did much to restore order after the serious confusion into which Treasury affairs had fallen under Secretary Chase. His efforts, fortified by a steadily increasing internal revenue, eventually

[91] "The tendency in every ill-ordered financial system is to increase the amount of the floating debt and so lessen that of the funded debt" (Gustav Cohn, *The Science of Finance*, trans. T. Veblen, Chicago: University of Chicago Press, 1895, p. 745).

[92] *Treasury Report*, 1863, p. 15.

[93] *Ibid.*, pp. 15-16.

[94] *Ibid.*, p. 16.

[95] He served from July 5, 1864, to March 3, 1865.

enabled the government to meet its obligations; and by the end of his term of office its credit had been greatly strengthened.[96] That the outcome of his eight-month period of service would be so favorable was not indicated by the conditions that obtained at its beginning.[97] On July 1, 1864,

> The cash balance in the Treasury was $18,842,558, and the unpaid requisitions were $71,814,000. The amount of certificates of indebtedness outstanding was $161,796,000. The daily expenditures exceeded two millions and a quarter. The larger portion of unpaid requisitions was for pay to the army, which would be increased over fifty millions on the 1st of September.[98]

Moreover, $110 million of the 7.3-per-cent notes issued in 1861 were to mature between August and October.[99] How critical the situation was is seen in the failure on July 2 of an offer of $32,459,700 of gold bonds originally advertised by Secretary Chase. It had to be withdrawn for want of acceptable bids.[100]

A wide variety of loan terms and maturities were available to the Secretary to choose from in deciding how best the public credit might be employed to relieve the Treasury. The loan Act of June 30, 1864,[101] authorizing a total of $400 million, gave him considerable discretion as to terms and maturities; he was permitted too to sell any five-twenty bonds authorized by earlier acts but still unsold; short-term interest-bearing Treasury notes of previous issues which had been redeemed and cancelled, amounting to $62,191,400, might be reissued; and there remained, under the Act of March 3, 1863,[102] authorization for $160,063,220 of various bonds and notes. Among the unused note authorizations were some having the quality of legal-tender.

He was determined, however, not to issue any short-term legal-tender notes if he could possibly avoid doing so. Failing to obtain a loan of $50 million from the large eastern banks, he sought, dur-

[96] *Memorial Addresses on the Life and Character of William Pitt Fessenden, Delivered in the Senate and House of Representatives*, 41st Cong., 2d Sess., Dec. 14, 1869 (Washington: Government Printing Office, 1870), Remarks by Mr. Morrill of Vermont, p. 32; Francis Fessenden, *Life and Public Services of William Pitt Fessenden* (Boston: Houghton, Mifflin & Co., 1907), I, 360, 362-363.

[97] Fessenden, *op. cit.*, I, 313-360.

[98] Bolles, *op. cit.*, p. 119.

[99] Dewey, *op. cit.*, p. 315.

[100] See Fessenden, *op. cit.*, I, 314.

[101] 13 Statutes 218.

[102] 12 Statutes 709.

ing the summer of 1864, to sell three-year 7.3-per-cent notes.[103] Although widely advertised, the loan sold slowly, for other more attractive issues were available to investors.[104] Seriously concerned with the problem of meeting arrearages in pay to the military forces, the Secretary offered, as a partial solution, the 7.3-per-cent notes, in small denominations, to those in the service who would accept them. More than $20 million worth were thus disposed of, reducing the claims against the Treasury by that amount.[105]

Late in August Fessenden reoffered the $32 million of gold bonds which had been withdrawn soon after they were offered late in June by Secretary Chase. More than twice the amount offered was bid for, and at a premium approximating 4 per cent.[106] This was followed by another offering on October 1. Five-twenty 6-per-cent bonds were advertised in the amount of $40 million, and were oversubscribed by 50 per cent, a premium of nearly one per cent being obtained.[107]

Another feature of Fessenden's endeavor to improve the debt structure was the conversion of a considerable amount of the one- and two-year 5-per-cent notes, which had been issued under the authorization of March 3, 1863.[108] These had become a particularly troublesome element in the debt.[109] In their place some $88 million in three-year 6-per-cent compound-interest notes was issued.[110] This was done by the Secretary with reluctance, for the new notes were legal tender, and it was not certain what part of them would enter into the circulation as currency.[111]

By the end of September, however, the condition of the Treasury was extremely precarious.[112] Hoping for an increase in the

[103] These were payable, principal and interest, in currency rather than gold, but were convertible into 6-per-cent five- to twenty-year gold bonds.

[104] Bolles, *op. cit.*, pp. 120-122.

[105] *Treasury Report*, 1864, p. 21.

[106] This improvement in saleability of the bonds was partly accounted for by the fact that payment could be made in compound-interest notes with accrued interest (Fessenden, *op. cit.*, I, 348-349).

[107] To bolster the market price of the large outstanding amount of certificates of indebtedness, which had fallen to 91 in Sept. 1864, one-fourth of the payment on this loan offering was made receivable in such certificates. See *Treasury Report*, 1864, p. 21; and Fessenden, *op. cit.*, I, 334, 350.

[108] 12 Statutes 710.

[109] See the description of them on page 47 below.

[110] By authority of the Act of June 30, 1864, 13 Statutes 218. See also *Treasury Report*, 1864, pp. 18-19; and Fessenden, *op. cit.*, I, 335.

[111] *Treasury Report*, 1864, pp. 18-19.

[112] Fessenden's biographer quotes Assistant Secretary George Harrington: "Few

sale of the 7.3-per-cent notes and for assistance from the banks, and wishing, no doubt, to avoid the criticism to which Chase had been subjected, Fessenden had hesitated to make use of the services of Jay Cooke.[113] While he delayed availing himself of this means of obtaining funds through popular subscription "the treasury became considerably embarrassed and the Government credit impaired."[114] "So threatening was the situation of the Treasury in October that the secretary stopped the issue of monthly statements of the public finances in order not to excite alarm . . . ."[115]

But time was now running in favor of the Treasury, for receipts from the internal revenue were steadily increasing. As a result the credit of the government was considerably strengthened. In December Secretary Fessenden was able to negotiate a $25 million loan with certain New York banks. On the tenth of that month he offered to redeem or convert into other notes or bonds the three-year Treasury notes of 1861.[116] At this point the services of Jay Cooke were again enlisted. Cooke successfully undertook to promote the sale of the remainder of the 7.3-per-cent Treasury notes authorized by the Act of June 30, 1864. Issued in denominations as small as $50 they now found a wide market.[117]

At first, short-term debt, demand notes, and greenbacks had predominated in financing the war. With the depreciation of the greenbacks and the enlarged supply of currency which the issue of those notes brought about, it became possible to sell long-term bonds at par or better. The policy of selling such bonds at par at moderate rates of interest had, before this, made them unattractive to investors. But later, since the interest on them was paid in gold coin each dollar of which had come to be worth two dollars—more or less—in greenbacks, the true yield on the bonds was much greater than the nominal, and the purchase of them at par with greenbacks was equivalent to the purchase of them for gold at approximately a 50-per-cent discount.

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outside or even inside the department either knew or appreciated the desperate condition of the Treasury" (Fessenden, *op. cit.*, I, 351-352).

[113] McCulloch, *op. cit.*, pp. 190-191.

[114] *Ibid.*, p. 191.

[115] Fessenden, *op. cit.*, I, 352.

[116] Bolles, *op. cit.*, p. 126.

[117] "The mere publication of the fact that he was again the government's fiscal agent bred confidence and enthusiasm in the people, and the money was poured forth in a flood" (Oberholtzer, *op. cit.*, I, 483).

Preference for these bonds continued through the latter part of the war as well as after its termination, and they continually sold at a premium.[118] So many were already outstanding, however, when Fessenden took office that he was reluctant to increase the amount very greatly lest the increased requirement of interest payments in gold should exceed the gold portion of the revenue and endanger the credit of the government through the risk of default.[119] He was convinced that the three-year 7.3-per-cent notes, on which the interest was payable in currency, were much more attractive to investors than longer-term bonds bearing interest in currency, and that the notes would involve a much smaller sacrifice, altogether, to the government.[120]

Secretary Fessenden held definite views with regard to the management of the debt. Only a part of them was he able to put into practice. He thought that the credit of the government might be improved by pledge of the proceeds from sale of public lands. Though he favored the establishment of a sinking fund, he considered such a fund impracticable so long as expenditures exceeded revenues. He was opposed to borrowing in foreign countries. The suggestion was made by him that wider discretion in negotiating loans should be accorded the Secretary of the Treasury, and that he should be empowered to increase the amount of currency in circulation. Yet in general he was opposed to further issue of legal-tender notes or of any form of debt which might cause an increase in the amount of currency in circulation. He urged that government loans be made as attractive as possible to the people, and that a wide distribution of them be sought. He favored notes bearing a relatively high rate of interest, but payable, interest and principal, in currency rather than gold, such notes to be convertible into gold bonds bearing a lower rate.

The Loan Act of March 3, 1865,[121] was, in a considerable measure, the expression of Fessenden's policies.[122] Not only had he directed the operations of the Treasury through a very difficult

[118] A. Barton Hepburn, *op. cit.*, p. 348.
[119] *Treasury Report*, 1864, pp. 23-24.
[120] *Ibid.*
[121] 13 Statutes 468.
[122] The original bill had been prepared by him, and officials of the Treasury had been repeatedly consulted regarding it while it was under consideration by Congress (*Congressional Globe*, 38th Cong., 2d Sess., Feb. 27, 1865, p. 1165; and Fessenden, *op. cit.*, I, 363).

period, during which the credit of the government greatly improved, but he had launched "the loan[123] which provided for the public expenditures of the coming year under his successor."[124] Besides the provision which it made for this financing, the act "prepared the way for funding the public debt at lower rates of interest."[125] The relationship of Treasury policy to the state of the money market was emphasized when the provision empowering the Secretary to issue gold-bearing bonds was debated in the House. That such influence over the money market was not regarded with disapproval is seen in the statement of Mr. Kasson, who, in defending the bill, and especially that provision of it, said, "By vesting this power in the Secretary of the Treasury we give him an important influence over the money market."[126]

By March, 1865, when Fessenden resumed his place in the Senate, the Treasury's position was substantially improved. New financial difficulties developed in the spring and summer, but they were resolved by September, when, at last, revenues exceeded expenditures.[127]

Perhaps the best brief summary of the course of Civil War finance is that made by A. Barton Hepburn in his *History of Coinage and Currency in the United States:*

Utter failure to foresee the probable length and magnitude of the war, hence failure to provide largely increased taxation, always unpalatable to short-sighted legislators; first resort to note-issues rendered necessary by the absence of a reputable currency system and of credit abroad through which specie could be drawn; the vain desire not to sell bonds at a discount, and consequent inability to sell them as rapidly as needs arose; wretched military administration and waste in innumerable ways; suspension of coin payments precipitated by unwise management and foreign complications; forced legal tender currency loans and expansion of prices, checking commodity exports and increasing expenses; heavy exports of specie naturally following; more legal tender currency, with further rise in prices and increases in expenses; repudiation of right

[123] By the end of May, 1865, Cooke had sold approximately $400 million of the $600 million authorized by this act (Fessenden, *op. cit.*, I, 362).
[124] *Ibid.*, I, 362-363.
[125] *Ibid.*
[126] *Congressional Globe*, 38th Cong., 2d Sess., Feb. 27, 1865, p. 1165.
[127] *Treasury Report*, 1865, p. 21.

to fund legal tender notes into bonds; wild speculation in specie which extended into all lines of business, enriching the shrewd few at the expense of the many. Net result,—ultimate cost to the people very much more than it would have been had they been taxed more heavily at the outset.[128]

[128] Pp. 202-203.

CHAPTER IV

The Debt at War's End

The Nature and Structure of the Debt

THE MAJOR wartime enactments authorizing loans were:[1]

Date of enactment	*Amount authorized*
July 17 and August 5, 1861	$250,000,000
February 25, 1862	500,000,000
March 3, 1863	900,000,000
March 3, 1864	200,000,000
June 30, 1864	400,000,000
March 3, 1865	600,000,000

During the course of the war many types of obligations were offered with a great variety of terms, and with varying degrees of success. Briefly summarized, the wartime obligations of the government, with the rates of interest and periods of time until maturity, were as follows:[2]

	Rate of Interest	Length of Loan
A. Long-term bonds:		
1. Loans of July and August, 1861	6	20 years
2. Five-twenties of 1862	6	5-20 years
3. Loan of 1863	6	17 years
4. Ten-forties of 1864	5	10-40 years
5. Five-twenties of June, 1864	6	5-20 years
6. Navy pension fund	3	Indefinite
B. Short-term loans:		60 days
7. Treasury notes of 1861	6	2 years
8. Seven-thirties of 1861	7 3/10	3 years

[1] See Bolles, *Financial History 1861-1885*, pp. 128-129; 12 Statutes 259, 313, 345, 709; 13 Statutes 13, 218, 468, in the order listed above.

[2] From Dewey, *Financial History*, p. 306.

9. One-year notes of 1863	5	1 year
10. Two-year notes of 1863	5	2 years
11. Compound-interest notes	6 compound	3 years
12. Seven-thirties of 1864 and 1865	7 3/10	3 years
C. Noninterest notes:		
13. Old demand notes	None	Indefinite
14. Legal-tender notes	None	Indefinite
15. Fractional currency	None	Indefinite
D. Temporary indebtedness:		
16. Temporary loans	4, 5, 6	Indefinite
17. Certificates of indebtedness	6	1 year

During the war period a considerable turnover of the debt took place. Redemption and conversion of maturing prewar debt and short-term war debt accounted for nearly a third of the total that was issued. The course of issuance and redemption, between 1861 and 1865, during which 32.8 per cent of the total amount issued was redeemed, is summarized, in millions of dollars, as follows:[3]

Year	1861-1862	1862-1863	1863-1864	1864-1865	1861-1865
Issued	489.3	776.5	1,128.9	1,475.0	3,869.7
Redeemed	51.7	181.0	432.9	603.4	1,269.0
Net Increase	437.6	595.5	696.0	871.6	2,600.7

Of this turnover, which, in round numbers, involved the redemption of $1,269 million of debt in the four-year period, $782 million was accounted for, in almost equal parts, by redemption of temporary loans and redemption of certificates of indebtedness. Another $125 million represented old demand notes, legal-tender notes, and fractional currency. The remainder, approximating $362 million, was in matured Treasury notes of one-, two-, and three-year terms, and some matured prewar obligations.[4]

The temporary loans referred to above[5] were an expedient which, when first proposed, was little understood and, by some members of Congress, strongly opposed. They were evidenced by certificates issued by the Treasury in exchange for funds deposited with it. On these deposits, especially popular with the

[3] *Ibid.*, p. 308.

[4] Based on data in Dewey, *op. cit.*, p. 308.

[5] First authorized by the Act of Feb. 25, 1862, 12 Statutes 346; and later authorized in increased amounts, 12 Statutes 370; 12 Statutes 532; 13 Statutes 218.

banks, 5-per-cent interest was at first paid, later 6 and 4 per cent. After being on deposit for thirty days they were callable on ten days' notice. The banks could use the certificates for paying balances at the clearing house. Almost a demand obligation, they became a substantial source of funds for the Treasury. Their liquidity, relatively high yield, and utility made them a highly satisfactory investment both for banks and for private individuals.[6] The amount authorized was limited to $150 million, and, although there was a considerable turnover, there was an almost continuous demand for them. During the war period approximately $482 million of these certificates were issued and $392 million redeemed.[7] They were continued after the war; and on June 12, 1866, $149.5 million of them were outstanding, the largest amount at any one time.[8] So great was the turnover of these temporary-loan deposits that, although a maximum of $150 million had been authorized, such deposits, altogether, finally totaled $716,099,247.16.[9]

Certificates of indebtedness were another temporary-loan innovation. Bearing a 6-per-cent rate of interest and payable one year from date, they were issued to those creditors of the government who were willing to accept them, for amounts of one thousand dollars or more. They were authorized without debate in Congress[10] by the Act of March 1, 1862;[11] by a later enactment which permitted their use in payment of checks drawn on the Treasury by disbursing officers;[12] and by yet another act which declared that their interest be paid in lawful money.[13] It was the tendency of these certificates to circulate freely, although they were in no way legal tender, until sufficient accumulation of interest enhanced their value to a point at which it became attractive to hold them as an investment.[14] They continued to be issued for a time after the termination of the war and were regarded as one of the "favorite securities" of investors.[15] No limit had been set on the amount that might be issued.[16] During the war period they had

[6] Bolles, *op. cit.*, pp. 88-92; Shultz and Caine, *Financial Development*, p. 298.
[7] Dewey, *op. cit.*, p. 308.
[8] Bolles, *op. cit.*, p. 91n.
[9] See Statement of the Outstanding Principal of the Public Debt, in *Treasury Report*, 1914, p. 204.
[10] Bolles, *op. cit.*, p. 92.
[11] 12 Statutes 352.
[12] 12 Statutes 370.
[13] 12 Statutes 710.
[14] Bolles, *op. cit.*, pp. 92-93.
[15] *The Commercial and Financial Chronicle*, I (Oct. 7, 1865), 449.
[16] 12 Statutes 352, 370, 710.

a considerable turnover, approximately $507 million having been issued and $390 million redeemed.[17] The total amount issued before their use was discontinued was $561,753,241.65.[18]

As described above, the three-year 7.3-per-cent Treasury notes of 1861 amounting to nearly $140 million were redeemed or converted into other notes and bonds late in 1864. Two other note issues were converted in part at about that same time. These were the one-year and two-year 5-per-cent notes issued by authority of the Act of March 3, 1863.[19] Of these, $44,520,000 and $166,480,000, respectively, had been issued.[20] These notes were of such a character that periodically they exerted a disturbing influence upon the currency of the country. Although legal tender and convertible into greenbacks they were not intended to circulate as currency. But it had been provided that the interest coupons attached to them must be clipped by an officer of the government. Because of this inconvenient requirement most of the notes were acquired by banks which, after cashing the matured coupons, placed the notes in circulation for a time. This was done in such volume that between interest dates the effect upon the total currency circulation was that of expansion followed later by contraction. The withdrawal of a part of these and their replacement with three-year 6-per-cent compound-interest notes, in the latter part of 1864, modified their effect upon the volume of the currency.[21] To what extent the compound-interest notes might become a part of the currency was a matter of conjecture with the Secretary.[22]

The three-year, 6-per-cent, compound-interest notes referred to above were yet another short-term-debt innovation of Secretary Chase. Although not specifically authorized by law, their issuance was proper under the discretionary powers provided the Secretary in the loan acts of March 3, 1863, and June 30, 1864.[23] They were legal tender at face value, the lowest denomination being $10. After three years their value per $100 became $119.40. Secretary Fessen-

[17] Dewey, *op. cit.*, p. 308.

[18] See Statement of the Outstanding Principal of the Public Debt, in *Treasury Report*, 1914, p. 204.

[19] 12 Statutes 710.

[20] *Treasury Report*, 1914, p. 205.

[21] *Ibid.*, 1864, p. 19; Bolles, *op. cit.*, pp. 124-125; Dewey, *op. cit.*, p. 312; Fessenden, *Life and Public Services*, I, 335.

[22] *Treasury Report*, 1864, p. 18.

[23] 12 Statutes 710; 13 Statutes 218.

den regarded them as the best form of interest-bearing legal-tender notes. He felt that they were more likely to be withdrawn from circulation by investors and held to maturity.[24] It would seem reasonable to suppose that the amount of such notes employed as currency would diminish as the accrual of interest enhanced their value. As Dewey[25] points out, however, the notes of larger denominations, by tending to become a part of the reserves of the banks, thereby released greenbacks, the increased circulation of which added to the excessive supply of currency. During the war period approximately $197 million was issued,[26] and eventually the total issue of them amounted to $266,595,440.[27]

The debt incurred during the war was predominantly in the form of demand and short-term obligations. Only 40 per cent of the total had maturities beyond three years. A brief summary of its composition,[28] in millions of dollars, shows

Long-term loans	$1,044.6
Interest-bearing notes	890.3
Non-interest-bearing notes	458.1
Temporary loans	207.7
Total	$2,600.7

Transition from War to Peace

Up to the very end of the war government expenditures had been extremely large. Between April and September, 1865, disbursements continued to exceed revenues, large sums being required for payment to the troops mustered out of the service and for closing up various accounts.[29] Although the public credit had improved substantially during Fessenden's brief term, the early months of McCulloch's administration were made difficult by several occurrences.

As the end of the war approached prices turned downward, and it was necessary to support the market for government bonds while sale of them to the public continued at a diminished rate. The War

[24] *Treasury Report*, 1864, p. 18.
[25] *Op. cit.*, p. 314.
[26] *Ibid.*, 308.
[27] Statement of the Outstanding Principal of the Public Debt, in *Treasury Report*, 1914, p. 204.
[28] Dewey, *op. cit.*, p. 316.
[29] *Treasury Report*, 1865, p. 21.

Department continued to precipitate old requisitions upon the Treasury. By March 30 these unpaid items approximated $100 million,[30] and on April 30 they amounted to more than $120 million, while the Treasury on that date commanded less than $17 million in cash.[31] To ameliorate this situation McCulloch and Cooke together worked out a plan for paying seven-thirty notes to such voucher holders as would accept them and keep them off the market for four months.[32] In April the assassination of the President temporarily disturbed the bond market, but prompt and adequate support prevented any serious break in prices.[33] As a consequence of these exigencies and the continuing deficit, the difficulties of the Secretary were augmented, and the debt increased until September, when revenues first exceeded expenditures.[34]

Between April 1 and September 1, 1865, the following securities were issued:[35]

Bonds under the Acts of February 25, 1862 and June 30, 1864	$ 10,023,600.00
Compound-interest notes, under Act of June 30, 1864	24,978,390.00
Certificates for temporary loans, under Act of June 30, 1864	54,696,384.87
Fractional currency, under Act of June 30, 1864	2,090,648.44
Seven-thirty notes, under Act of March 3, 1865	529,187,200.00
Total	$620,976,223.31

In September and October the public debt declined approximately $13 million.[36] Although Secretary McCulloch forecast heavy expenditures for the remainder of the fiscal year 1866, he estimated for 1867 a balance of $111 million which could be applied to reduction of the debt.[37] The prospective surplus heralded a new era in Federal financing.

[30] Oberholtzer, *Jay Cooke*, I, 519.
[31] McCulloch, *Men and Measures*, p. 245.
[32] Oberholtzer, *op. cit.*, I, 519-522.
[33] McCulloch, *op. cit.*, pp. 226-227; Oberholtzer, *op. cit.*, I, 532-536.
[34] *Treasury Report*, 1865, p. 21.
[35] *Ibid.*, 1867, p. iii.
[36] *Ibid.*, 1865, p. 21.
[37] *Ibid.*

With it came new problems, paramount among which were funding of the debt into more manageable form, revision of the tax structure, and restoration of the value of the nation's currency.

The Debt at Its Maximum

For some time after the war had ended the debt continued to increase, until on August 31, 1865, it reached its highest point. It seems generally to have been expected that the total indebtedness would approximate $3,000 million;[38] and contemporary observers of government finance were unaware on that date that the debt had reached its zenith. In the *Treasury Report* for 1864, the Commissioner of Internal Revenue, Mr. Joseph J. Lewis, in urging the need for "a permanent system of internal taxes," projected his estimates on the basis of a debt of "four thousand millions of dollars."[39] On August 19, 1865, an editorial in a leading New York City financial weekly estimated that the debt would be at least $3,000 million.[40] When late in that year Secretary McCulloch was preparing his annual report to Congress he made this same estimate, taking no notice of the status of the debt on the preceding August 31:

> The national debt, deducting moneys in the treasury, was, on the 31st of October, 1865, $2,740,854,750 . . . it seems safe to estimate it, on the 1st of July, 1866, at three thousand millions of dollars.[41]

The following summary appeared in the *Treasury Report* for 1867:[42]

> On the 31st of August, 1865, the public debt reached the highest point, and was made up of the following items, to wit:

Funded debt	$1,109,568,191.80
Matured debt	1,503,020.09
Temporary loans	107,148,713.16
Certificates of indebtedness	85,093,000.00
Five per cent. legal tender notes	33,954,230.00
Compound interest legal tender notes	217,024,160.00
Seven-thirty notes	830,000,000.00
United States notes, (legal tenders)	433,160,569.00

[38] The term "billion," now practically a household word, was not then employed by financiers.

[39] *Report of the Commissioner of Internal Revenue*, pp. 72-73.

[40] *The Commercial and Financial Chronicle*, I, 226.

[41] *Treasury Report*, 1865, p. 22.

[42] Pp. iii-iv.

Fractional currency	26,344,742.51
Suspended requisitions uncalled for	2,111,000.00
Total	$2,845,907,626.56
Deduct cash in treasury	88,218,055.13
Balance	$2,757,689,571.43

Of these obligations, it will be noticed, $684,138,949 were a legal tender, to wit:

United States notes	$ 433,160,569.00
Five per cent. notes	33,954,230.00
Compound interest notes	217,024,160.00
	$ 684,138,959.00

Public Opinion and the War Debt

It has been indicated how, during the administration of Secretary Chase, public opinion was a significant consideration in some of his policies. The attitude toward the sale of bonds in foreign markets and the sale of bonds below par has been noted. Other public prejudices, such as those against payment of commissions to a loan agent and against borrowing from the banks had, at times, a restraining influence on Treasury policy.

In his dealings with Jay Cooke, Chase had been continually cautious, apparently always aware of potential public disfavor both with regard to the Treasury's relations with a private financial house and with regard to the rate of commission paid to the agent.[43] Fessenden, knowing that Chase had been criticized for retaining Cooke, delayed re-engaging him until he could no longer avoid it.[44] Since he was soon to return to the Senate where he could readily defend his own Treasury policies as well as those of his successor, and because he wished to spare his successor[45] the burden of decision in this matter, Fessenden engaged the services

[43] See Oberholtzer, *op. cit.*, I, *passim*.

[44] McCulloch, *op. cit.*, pp. 190-191; Oberholtzer, *op. cit.*, I, 429-435.

[45] He had a high regard for McCulloch. Though sensitive to public criticism, Fessenden maintained the viewpoint of a statesman. His foresight, shared by Congress, in preparing the loan bill enacted on March 3, and his determination, early in 1865, to retain Cooke, did much to prepare the way for Secretary McCulloch, who later, through his conversion operations, was to acquire a certain amount of renown.

of Cooke[46] for the sale of the $600 million loan authorized on March 3, 1865.[47]

But suggestions, as well as adverse criticism, were forthcoming from the public. A patriotic people who knew the significance of personal debt were becoming aware of the magnitude of their government's commitment. Well before the end of the war, and long before the debt reached its highest point, public interest in the debt and concern regarding it were expressed in a variety of ways. To an embarrassing extent the Treasury Department became the recipient of many well-intentioned suggestions:

> . . . torrents of advice of the most contradictory character were poured upon the department from financiers, theorists, business men, and persons of all sorts. One wanted nothing but gold bonds, another nothing but currency bonds, another wanted billions of paper, another was naively opposed to paying interest. One sober-minded individual advised a seven [dollar] per capita tax on everyone who danced. Some writers sent their opinions to the President, and asked him to enforce them on the secretary.[48]

Thus was foreshadowed the intense postwar public interest in the debt and in all the financial ramifications with which its management was concerned. When, for example, such great issues as contraction of the currency and resumption of specie payments were widely discussed and heatedly debated, the importance of the relation of Treasury policies to the state of the national economy, and indeed to the financial interest of every individual, became

[46] Letter from Henry D. Cooke to Jay Cooke, Jan. 23, 1865, quoted in Oberholtzer, *op. cit.*, I, 470.

[47] It was fortunate that he did this, for with the approaching termination of the war prices generally turned downward, yet the Treasury's need for funds continued unabated. Cooke's biographer states that Cooke acted for the Treasury in supporting the government-bond market at the same time that he continued the sale of the seven-thirties to the public at a somewhat reduced rate. According to this authority, upon the assassination of the President, Cooke, without authorization, ordered his New York agents to support bond prices by unlimited purchases in order to avert a panic. See Oberholtzer, *op. cit.*, I, 498-509, 532-536.

McCulloch's account of the support of the bond market following Lincoln's assassination does not mention Cooke: "Through a trusted agent, [bonds] were purchased by Mr. John A. Stuart, the Assistant Treasurer, under instructions which I had given him, and the market at once resumed a healthy tone . . . . A panic was . . . to be prevented before it had obtained headway, and it was prevented by the prompt and prudent action of Mr. Stuart. In one or two other cases the market was steadied in the same way" (*op. cit.*, pp. 226-227).

[48] Fessenden, *op. cit.*, I, 358.

pointedly clear. The question whether the debt was a "blessing" or a "burden" received widespread consideration.

There were at this time some who saw more advantage than disadvantage in a large national debt. An article in the *Commercial and Financial Chronicle* compared the cost of winning the war to a capital improvement which would increase the earning power of the nation. It stated:

> . . . a national debt . . . may be so managed as to stimulate productive power and augment the force of inventive genius, to economise capital and open a beneficent reservoir for gathering together and rendering more productive ten thousand little fertilizing streams of national wealth.[49]

A pamphlet[50] circulated during Jay Cooke's bond-selling campaign in the spring and summer of 1865 asserted, "The debt is public wealth, political union, protection of industry, secure basis for national currency, the orphans' and widows' savings fund." It went on to aver:

> We lay down the proposition that our national debt, made permanent and rightly managed, will be a national blessing.
>
> . . . . . .
>
> The funded debt of the United States is the addition of three thousand millions of dollars to the previously realized wealth of the nation. It is three thousand millions added to its available active capital. To pay this debt would be to extinguish this capital and lose this wealth . . . an inconceivably great national misfortune.

Here and there a note of opposition to the debt was heard,[51] and this foreshadowed the strong movement for repudiation which was to develop a few years later. When the war ended a few upheld the proposition that it was wrong to pay interest largely to the wealthy class at the expense of the many poor. Later this sentiment became widespread.

[49] I (Aug. 19, 1865), 226.

[50] Samuel Wilkeson, *How Our National Debt May Be a National Blessing* (Philadelphia: M'Laughlin Brothers, printers, 1865), title page, and pp. 3, 6.

Cooke had to meet the objection that the country would be ruined by the enormous debt. See Fritz Redlich, *Essays in American Economic History* (New York: G. E. Stechert & Co., 1944), pp. 174-189.

[51] See, for example, A. Campbell, *The True American System of Finance and the Common Sense Way of Doing Justice to the Soldiers and Their Families; No Banks: Greenbacks the Exclusive Currency.* (Chicago: Evening Journal Book and Job Print, 1864).

More generally, however, it was assumed that the entire debt eventually would be paid.[52] Even before it was clearly established that deficits had given way to a surplus, estimates were being made to determine how rapidly the debt might be reduced and finally expunged. It was remarked in the London *Economist* that—

> . . . there is scarcely a provincial town [in the United States] in which some financial person—some banker or stockbroker—has not made and published calculations as to the quickest and best mode of paying off the great debt. Such a diffused interest must soon create real knowledge.[53]

Secretary McCulloch estimated 27 to 29 years for its payment.[54] Freeman Clarke, the Comptroller of the Currency, calculated 32½ years.[55] At first greater emphasis was placed upon the desirability of debt reduction[56] and the need for achieving a secure control over the debt by means of its conversion,[57] than upon its possible utility. The total debt was so much greater than any amount conceivably required as a basis for national-bank circulation[58] that the need for its existence to secure currency of this kind was not then stressed.[59]

The greenbacks, although non-interest-bearing and of no stated maturity, were a substantial fraction of the total debt. Their destiny was an important part of the conversion policies of the period. Because they circulated as a medium of exchange, great controversy centered upon them, both with regard to the contraction or expansion of the amount in circulation and the manner of resuming specie payments upon them. Whether this segment of the debt

[52] "From the time that Gallatin assumed control of the Federal Treasury to the present, the American people have manifested a strong dislike to the perpetuation of a funded debt" (Henry C. Adams, *Public Debts*, New York: D. Appleton & Co., 1887, p. 240).

[53] XXIV (April 14, 1866), 439.

[54] *Treasury Report*, 1865, pp. 23-25.

[55] *Report of the Comptroller of the Currency*, 1865, p. 68.

[56] *Treasury Reports*, 1865-1869; *Reports of the Comptroller of the Currency*, 1865-1869.

[57] See *Merchant's Magazine and Commercial Review*, 1865-1867; *Commercial and Financial Chronicle*, 1865-1867; *Bankers' Magazine and Statistical Register*, 1865-1867.

[58] Late in 1865 the Comptroller of the Currency proposed a limit of $400 million of national-bank currency. The total debt, excluding the greenbacks, was six times this amount. See *Report of the Comptroller of the Currency*, 1865, pp. 66-67; *Treasury Report*, 1865, p. 17.

[59] The national-bank-note circulation was regarded, however, as one of the compensations for the heavy burden of debt (*Report of the Comptroller of the Currency*, 1864, p. 48).

was a blessing or a burden was a matter of viewpoint on the part of those whose financial interest or economic philosophy was concerned.

That part of the debt which was held in foreign countries was regarded as more of a burden than the internally held debt, both because of the export of specie which its servicing required and the potential threat to stability in American markets when financial stringency abroad might force heavy sales of government securities.[60] In 1866 it was estimated that some $600 million in American securities—both public and private—was held in Europe.[61] By 1869, it has been estimated, Europeans had invested almost a billion and a half dollars in American securities, chiefly Federal government and railroad bonds.[62]

The burden of the debt was generally viewed with a direct regard to the ability of the country to meet the interest charges and to make substantial annual payments on the principal.

> The real burden of our debt is to be estimated more by the annual pressure on our resources than by the amount of the principal.[63]
>
> It is undeniably large, but the resources of the country are even now ample to carry and gradually to reduce it.[64]

That the debt could be a burden in less simple and direct ways was also envisaged:

> . . . the present pressure of a National debt upon the resources of the people does not depend so much upon the nominal aggregate of that debt, as upon the amount of the annual interest it calls for, the methods of taxation used to collect the amount, and the sacrifices which these taxes entail by the interruption of the industry of the toiling masses of the population.[65]

A contemporary authority on public finance referred to "that preposterous theory which considers a national debt as a 'national blessing,'" and added, "it is capital to those only who hold it and a tax to everybody else . . . . There is consequently a general aggregation of the general wealth to increase particular wealth . . . ."[66]

[60] *Treasury Report,* 1866, pp. 12, 23. [61] *Ibid.,* p. 12.
[62] *Report of the Special Commissioner of the Revenue,* 1869, pp. xxvii-xxix.
[63] *Commercial and Financial Chronicle,* II (June 9, 1866), 706.
[64] *Treasury Report,* 1865, p. 22.
[65] *Merchant's Magazine,* LVII (Oct., 1867), 298.
[66] J. S. Gibbons, *The Public Debt of the United States* (New York: Charles Scribner & Co., 1867), pp. 57, 59.

Secretary McCulloch forthrightly stated his view that the debt was a burden and not a blessing. There might be minor advantages in a national debt, but

> There can be no reasonable doubt that a national debt is a national burden, for which there can be no substantial counterbalancing compensations.[67]
>
> While it would be foolish to call it a national blessing, it may be so managed as not to be a national calamity.[68]
>
> The burden of a national debt is, of course, relative to the national resources, and these resources are not, strictly speaking, capital, but the current product of the capital and industry of the country.[69]

A distinguished contemporary economist writing for a popular magazine referred to a report made by the Secretary of the British Legation to his government in which he said:

> The majority of Americans would appear disposed to endure any amount of sacrifice rather than bequeath a portion of their debt to future generations.[70]

The article went on to point out that the desire to pay off debt was an American trait. It described this as a

> . . . strong and controlling sense that debt was always and everywhere an evil; that it was a good thing to "work off" the mortgage, even if it involved working very hard.[71]

Bolles, the financial historian, said of the public attitude toward the debt in this period:

> From the first, the policy of national debt-paying has been widely favored. Some interests which would be better served by continuing the debt have sought to reverse this policy, but the voice of the people has been quite unanimous.[72]

By 1869, however, it was apparent that the early enthusiasm for reducing the debt had subsided. The "seductive philosophy of

[67] McCulloch, *op. cit.*, p. 472.

[68] Letter from Hon. Hugh McCulloch, Secretary of the Treasury, to Henry C. Carey, Esq., Philadelphia, April 4, 1865. Printed in *Bankers' Magazine*, XIX (May 1865), 916-918.

[69] *Treasury Report*, 1865, p. 24.

[70] Francis A. Walker, "The National Debt," *Lippincott's Monthly Magazine*, IV (Sept., 1869), 316.

[71] *Ibid.*, p. 318.

[72] Bolles, *op. cit.*, p. 305.

'fructification' "—namely, that money left with the people increased more rapidly than if transferred into the public treasury—was gaining ground, and the idea of waiting for better times was growing.[73]

There was fear on the part of some that a permanent debt might become a means of exploitation by those who benefited from it. In some areas of public opinion the American debt situation was compared with that of the British, by which, it was supposed, the British people had long been oppressed: "Direct robbery by force could not have obtained this [oppression] so effectually as has been done through the creation of a permanent national debt."[74] Reference was made to " . . . moneyed institutions and heavy capitalists, who have immense sums to invest, and would like to have the nation guarantee the annual interest upon the same to themselves and their successors."[75]

It was believed that payment of the debt would produce "active capital" which "would be compelled to take its legitimate share of the risks and responsibilities of business";[76] and that reduction of debt was a means of preparation "for any great struggle."[77] To those who held these opinions the debt as such was inactive capital and its retention was a downright evil: "... a national debt ... is in fact a great calamity, an incubus upon industry, and an increasing source of official corruption."[78]

The most extreme opposition to the debt was among those who sought its extinguishment by means which, in effect, amounted to repudiation. President Johnson's astonishing proposal that interest payments be counted as payment of principal[79] exemplified the faulty thinking and lack of comprehension on the part of many of his contemporaries. Just as extreme were the proposals of the various inflationist groups which favored redemption of the debt with fiat paper money.[80]

[73] Walker, *op. cit.*, p. 318.

[74] "Conversion of the National Debt into Capital," *Lippincott's Monthly Magazine*, I (June, 1868), 641.

[75] *Ibid.*, p. 639.

[76] *Ibid.*, p. 644.

[77] *Ibid.*

[78] *Ibid.*, p. 643.

[79] Richardson, *Messages and Papers of the Presidents*, VI, 678.

[80] See, for example, Solon J. Buck, *The Agrarian Crusade: A Chronicle of the Farmer in Politics* (New Haven, Conn.: Yale University Press, 1921), pp. 79-81; James A. Garfield, "The Currency Conflict," *Atlantic Monthly*, XXXVII (Feb., 1876), 219-236.

In a general way, in the postwar period, there were three trends of public opinion with regard to the debt: (1) that it should be reduced as rapidly as possible from surplus revenues, (2) that it should be made permanent or reduced only gradually, (3) that it should be converted into fiat paper money. At the end of the war opinion had been emphatically in favor of rapid debt reduction, but well before 1870 there had developed a considerable sentiment, on the one hand for delay in paying it, on the other, for some degree of repudiation, usually by means of currency inflation. These three points of view continued for many years, but, so far as it was a matter of public opinion, the first of them—that the debt ought to be paid—predominated.

Thus it appears that at the war's end before the weight of the public debt could be appraised on the basis of a peace-time economy, it was viewed more as a burden than an advantage, and opinion generally favored its reduction. For the most part the debt burden was conceived of simply in terms of its total amount and the amount of annual payments required to service it. The later advantages and disadvantages of the debt were to be numerous, and subject to various interpretations. The relation of debt-management activities to fiscal and monetary policy as well as to the over-all production, exchange, and distribution of the growing wealth of the country could at best be imperfectly foreseen in the early postwar years. It is significant, however, that at the time when policies for the conversion and funding of the debt were being formed, prevailing opinion favored its reduction and eventual elimination.

CHAPTER V

Preliminary Funding of the Short-Term Debt

Objectives and Policies of Secretary McCulloch

When secretary mcculloch assumed his duties at the Treasury in March, 1865, the only avowal of policy which he made was to state his chief aim: "to provide the means to discharge the claims upon the Treasury Department at the earliest day practicable, and to institute measures to bring the business of the country *gradually* back to the specie standard."[1] Nearly two years later he wrote, "My object has been to keep the market steady, and to work back to specie payments without a financial collapse. I shall act in future as I have in the past, with great caution, and attempt no impracticable thing."[2]

The execution of his policies was limited by Congressional legislation which, though it restricted him in some respects, gave wide latitude for carrying out the conversion operations.[3] His loyalty to President Johnson was based upon respect.[4] In the President's first annual message he had expressed views on the finances of the country practically identical with those of his Secretary.[5] But McCulloch did not concur when, in the last year of the administration, the President "wandered so far from right thought"[6] as to

[1] Letter to Henry C. Carey, April 4, 1865, printed in the *Bankers' Magazine*, XIX (May 1865), 916-918.

[2] Letter to E. G. Spaulding, Dec. 7, 1866, printed in the *Merchant's Magazine*, LVI (Jan., 1867), 88.

[3] Bolles says of the Act of April 12, 1866 (14 Statutes 31), which authorized the conversion of the debt and contraction of the currency, "No law was ever passed by Congress granting so much authority to the secretary in the management of the debt and currency" (*Financial History, 1861-1885*, p. 310).

[4] In his speech at Fort Wayne he had praised the President's ability, honesty, and good judgment (*Our National and Financial Future, Address at Fort Wayne, Indiana, October 11, 1865*, Fort Wayne, 1865, pp. 8-9).

[5] Richardson, *Messages and Papers of the Presidents*, VI, 364-366.

[6] McCulloch, *Men and Measures*, pp. 220-221.

suggest that "interest now paid by the Government should be applied to the reduction of the principal . . . which in sixteen years and eight months would liquidate the entire national debt."[7]

In the formulation of financial policies McCulloch was not influenced by opinions of other members of the Cabinet. He says of this:

> Financial matters had not been discussed at the Cabinet meetings before I became Secretary, and they were not as long as I continued in office. Each member had as much as he could do in the management of his own department, and it seemed to be generally understood that each should act independently in the work that was devolved upon him by his position. My policy, therefore, like that of my immediate predecessor, was neither directed nor influenced by my associates in the Cabinet, nor did I think it advisable to go elsewhere for advice.[8]

Unlike his immediate predecessors, McCulloch had been a banker. His able management of the Bank of the State of Indiana had led to his appointment as the first Comptroller of the Currency under Chase. His views were conservative, and he was relatively little influenced by considerations of political expediency. His great objective was to restore the value of the currency and enhance the public credit. To this end he sought to contract the greenbacks, reduce the debt, and convert the great mass of floating and short-term obligations into bonds. The program of debt reduction and conversion was generally approved. His strict policy of currency contraction, however, met with widespread and clamorous opposition and detracted from his prestige with Congress.

The position was not a comfortable one for a conservative banker. Inflationist sentiment throughout the country at this time cast its shadow upon the public credit, and the repercussions of a financial crisis in Great Britain in the spring of 1866 strengthened the arguments of those who opposed a conservative Treasury policy. Not only the vast amount of debt to be converted and the limited period of time in which it might be done, but also the confusion of thought and purpose with regard to financial matters in the minds of the people and their representatives, contributed to the necessity for a high interest rate at a time when, for other reasons,

[7] Richardson, *op. cit.*, VI, 678.
[8] McCulloch, *op. cit.*, p. 199.

a lower rate would have been possible. The public credit at home and abroad was not all that it might have been.[9]

The Short-Term Nature of the Debt

Secretaries Chase and Fessenden had regarded the short-term nature of the debt as an advantage, believing that it would make easily possible the reduction of the debt and its funding on favorable terms after the war.[10] McCulloch, however, saw the immediate necessity of bringing under control this huge amount of floating and short-term obligations to strengthen the public credit and forestall possible embarrassment to the Treasury should unfavorable financial conditions develop. In his report for 1865 he stated, "The first step to be taken is to institute measures for funding the obligations that are soon to mature."[11] Later, in his memoirs, he wrote, "For nearly three years after I became Secretary I had enough to do . . . in funding the immense amount of temporary obligations . . . this great, and in some respects difficult, work."[12] In particular he feared that a Supreme Court decision against the Legal Tender Acts might cause financial disturbance and seriously hinder the conversion program, for he believed that these acts would be found unconstitutional:

> I was greatly relieved when all the temporary obligations of the Government had been converted into bonds, and the Treasury Department was prepared for the expected decision, that the Legal Tender Acts were not warranted by the Constitution.[13]

The case was dismissed, however, and the question was not decided until after McCulloch had left the Treasury.

A controllable arrangement of maturities was first in importance, but the consolidation and simplification of the debt were also highly desirable. The structure of the debt was such that it con-

[9] *Treasury Reports,* 1865-1868, *passim; Congressional Globe,* 39th Cong., 1st Sess., Feb. 21, March 16, 19, 23, 1866, pp. 971-978, 1456-1468, 1496-1502, 1608-1614; Alexander Dana Noyes, *Forty Years of American Finance* (New York: G. P. Putnam's Sons, 1909), pp. 1-16; Barrett, *The Greenbacks,* pp. 156-168; George S. Boutwell, *Reminiscences of Sixty Years* (New York: McClure, Phillips & Co., 1902), II, 125-127; E. R. A Seligman, *Currency Inflation and Public Debts* (New York: The Equitable Trust Co., 1921), pp. 26-27; *Merchant's Magazine,* LIV-LIX (Jan. 1866-Dec., 1868), *passim; Commercial and Financial Chronicle,* II-IX (Jan., 1866-Dec., 1869), *passim.*

[10] *Treasury Report,* 1863, pp. 14-15; 1864, p. 24.

[11] *Ibid.,* 1865, p. 16.

[12] *Op. cit.,* p. 247.

[13] *Ibid.,* p. 172.

tributed in some measure to the impairment of the public credit. Not only was the Treasury vulnerable in case of financial stringency and a falling off of revenues, but the extreme complexity of interest rates, maturities, and other provisions placed the debt "in such a state of confusion as to be entirely out of reach of the popular understanding, and correspondingly out of the popular confidence."[14]

Although it was widely believed that the rate of interest paid by the government was too high,[15] and although the Secretary envisaged and members of Congress demanded a reduction in interest, it proved necessary to carry out the entire conversion with 6-per-cent bonds. Reduction of the interest burden was to come about later through debt redemption and refunding operations.

During the first six months that McCulloch was Secretary important changes in the status of the debt took place. At the time, with the aid of Jay Cooke, $530 million three-year 7.3-per-cent notes were sold. This eased the pressure of deferred claims. Increasing revenues made possible the payment of almost $100 million of certificates of indebtedness. In October approximately $50 million of the compound-interest notes were converted into the five-twenty 6-per-cent bonds authorized by the Act of March 3, 1865. By August 31 the cash balance in the Treasury had risen to $88 million. What seemed to be a less favorable development was the increase in the volume of certificates of deposit which were payable virtually on demand. Between March 31 and September 30 these increased by $63,433,420 to a total of $115,885,747, and by June 1866 there were $149.5 million of such certificates outstanding. So large an amount, payable on ten days' notice, made the Treasury especially vulnerable in case of financial stringency. It also made necessary the retention of an abnormally large Treasury balance. The belief was widely held that the Secretary should use a part of the large cash balance to "pay off a considerable portion of these mischievous and useless call loans" and that more of the certificates of indebtedness, which ran for twelve months, bore 6 per cent in currency, and were generally well liked, might wisely be negotiated

[14] Gibbons, *The Public Debt*, pp. 38-39.

[15] The *Commercial and Financial Chronicle* expressed the opinion that the time was not far off when 5-per-cent United States bonds would sell at a premium, but to obtain the large sum needed in a limited time resort to 6-per-cent bonds was necessary, III (July 7, 1866), 3.

rather than maintain the temporary deposits at so high a level. Secretary McCulloch, however, was not eager to create more of this form of debt, for he hoped that soon the necessity of "raising money by any kind of temporary loans" might be obviated.[16]

When the debt was at its highest point, some months after the termination of the war, less than 40 per cent of it had maturities beyond three years. On August 31, 1865, the gross debt[17] was $2,845,907,626.56. Of this amount, $1,109,568,191.80 was in funded form. As the term was then used, "funded debt" included all maturities of more than three years. It consisted only of bonds, and did not include the three-year 7.3-per-cent notes.

Of the remainder of the debt, $433,160,569.00 was represented by greenbacks and $26,344,742.51 by fractional currency. Thus, excluding the greenbacks and fractional currency, $1,276,834,123.25 of the debt was in floating or short-term form.[18] The magnitude of this sum may be indicated by a comparison with the annual ordinary receipts of the Treasury, which in the fiscal year 1865 had increased to approximately $333 million, having been only $56 million in 1860.[19]

Besides greenbacks and fractional currency there were outstanding on August 31, 1865, five major types of obligations to which the process of funding might be applied:

(1) The temporary loans made to the government in the form of deposits with the Treasury, payable thirty days after deposit, upon ten days' notice, amounting to $107,148,713.16;

(2) The certificates of indebtedness which were to fall due on various dates between August 31, 1865, and May 2, 1867, amounting to $85,093,000.00;

(3) The 5-per-cent notes, which were payable in one and two years from December 1, 1863, amounting to $33,954,230.00;

(4) The compound-interest legal-tender notes, payable in three years from the various dates of their issuance, all maturing between June 10, 1867, and October 16, 1868, amounting to $217,024,160;

[16] *Treasury Reports,* 1865, pp. 21, 36-37; 1867, p. iv. *Commercial and Financial Chronicle,* I (Oct. 7, 1865), 449; II (March 3, 1866), 257. *Merchant's Magazine,* LIII (Nov., 1865), 336-337; LIV (March, 1866), 230. Bolles, *op. cit.,* p. 91. The significance of this use of the certificates of deposit is discussed in a later chapter.

[17] By "gross debt" is meant the total indebtedness before deducting cash in the Treasury. At this time Treasury cash amounted to $88,218,055.13.

[18] Data derived from *Treasury Report,* 1867, pp. iii-iv.

[19] *Ibid.,* 1950, p. 450.

(5) The 7.3-per-cent notes (known as the "seven-thirties"), which were payable in about equal amounts in August 1867 and June and July 1868, being convertible when due, at the option of the holder, into five-twenty 6-per-cent bonds, amounting to $830,000,000.[20]

The Loan Act of 1866

McCulloch had made a good beginning toward reorganization of the debt before Congress took action to implement and, in a measure, direct his course of action by means of legislation. The Act of April 12, 1866,[21] provided for conversion of the floating and short-term debt into bonds authorized by earlier loan acts. The act also provided for a moderate contraction of the greenbacks. The conversion authorization was in accordance with recommendations made by the Secretary,[22] but the strict limitation on greenback contraction was a disappointment, for he had sought a free hand in the management of this element of the debt.[23] The bill had been hotly debated in the House, where opposition both from inflationists and from those who objected to too much power in the hands of one official led to its defeat.[24] It was revived by means of parliamentary strategy when there were embodied in it restrictions upon the power of the Secretary so that the rate of contraction remained in the control of Congress.[25]

This loan act was an amendment to the Loan Act of March 3, 1865. It authorized the Secretary—

> at his discretion, to receive any Treasury notes or other obligations issued under any act of Congress, whether bearing interest or not, in exchange for any description of bonds authorized by the act to which this is an amendment; and also to dispose of . . . bonds . . . either in the United States or elsewhere, to such an amount, in such manner, and at such rates as he may think advisable.[26]

[20] *Ibid.*, 1867, pp. iii-iv.
[21] 14 Statutes 31.
[22] *Treasury Report*, 1865, p. 22.
[23] *Ibid.*, 1866, pp. 8-9; McCulloch, *op. cit.*, p. 211.
[24] *Congressional Globe*, as cited above.
[25] *Ibid.*; Blaine, *Twenty Years of Congress*, II, 324-326. The *Commercial and Financial Chronicle* referred to this legislation as "One of the most important and most efficiently performed duties of Congress during the last session," III (Dec. 1, 1866), 675.
[26] 14 Statutes 31.

Although no definite amount of bonds was specified for this purpose, the debt was not to be increased by their issuance and the funds raised were to be applied only to conversion.[27] A type of bond known as the "five-twenty," made popular during the war, was decided upon. By their terms these bonds were redeemable in five years and payable in twenty years. They bore 6-per-cent interest in coin. By issuing just this one form of obligation a large part of the debt was consolidated and funded into a single type of bond and the debt structure was greatly simplified.[28] This legislation had the virtues of simplicity and timeliness; thus the conversion plan which it authorized was made understandable to most people.

Senator James G. Blaine, commenting in his memoirs on the nature of this legislation, pointed out the significance of the way in which it was evolved and the ultimately democratic rather than bureaucratic control over Treasury activities which it provided. He wrote:

> The enactment of this bill presents in an instructive light the character of our financial legislation and the methods by which it is accomplished . . . .
>
> Congress . . . did not enact anybody's theory. It put into the statute the prudent, cautious sense of the people. Recognizing the principle of funding the floating obligations, and of contraction as a means to resumption, Congress only responded to the common sense of its great constituency, in forbidding reckless haste, and in defining the rate of speed. The purpose of keeping in Congress the control of the rate of contraction was only a part of the general determination that the representatives of the people and of the States shall prescribe the methods of conduct as well as the principles and broad measures of administration.[29]

Senator John Sherman was the only member of the Committee on Finance to oppose the bill. Many years after its passage he still believed that "it was by far the most injurious and expensive

[27] *Ibid.*

[28] To insure the success of a conversion operation it should be timely, simple, easily understood by the public, should not increase the debt, and should tend to simplify its structure. See C. F. Bastable, *Public Finance* (3d ed.; London: Macmillan & Co., Ltd., 1903), pp. 706-707; G. Findlay Shirras, *Science of Public Finance* (3d ed.; London: Macmillan & Co., Ltd., 1936), II, 860.

[29] *Twenty Years of Congress,* II, 325-326.

financial measure ever enacted by Congress. It not only compelled the United States to pay the large war rates of interest for many years, but postponed specie payments until 1879." He believed that McCulloch could have funded the interest-bearing notes and certificates at 4 or 5 per cent instead of 6 per cent, and that his failure to use his power to do so increased the burden of the debt, deranged business, and led to much dissatisfaction among the people.[30]

Because of the prominent part which Sherman took in the guidance of financial legislation for many years, and because of his able preparation for resumption when he served as Secretary of the Treasury a decade later, his view of the Loan Act of 1866 is of interest, if only to indicate how divergent opinion could be even among the most able men and at the highest level of financial statesmanship. It must be added that a broad and careful study of the circumstances obtaining at the time of the enactment shows that Sherman was mistaken, that it was utterly unrealistic to suppose that lower interest rates might have been obtained in the brief and chaotic period during which so immense a sum of debt was to fall due.

The Conversion Operations

Before the passage of the Loan Act of 1866 McCulloch had been urged to make greater use of the compound-interest notes—a favored form of security—as a device for eliminating the greenbacks and gradually reducing the total amount of legal-tender debt. The suggestion was to convert the greenbacks into these notes, which, as the interest on them accumulated, would tend to disappear from circulation and be held as an investment, for they were legal tender only at their face value. They should continue to be eligible as bank reserves only to the date of their maturity, which was three years after their date of issue. As they came due at intervals they could be funded on liberal terms into bonds.

To contract the greenbacks in this way would probably not have required an act of Congress,[31] although there was some belief that the Secretary had authority only to "convert them directly into bonds."[32] McCulloch himself had recommended that these notes

[30] Sherman, *Recollections*, I, 378-387.

[31] In the opnion of the *Commercial and Financial Chronicle* the Acts of June 30, 1864 (13 Statutes 218), and March 3, 1865 (13 Statutes 468), gave "all the authority which is necessary," II (March 10, 1866), 290.

[32] *Merchant's Magazine*, LIII (Nov., 1865), 336-337; LIV (Feb., 1866), 126-127.

cease to be legal tender at maturity,[33] but he did not favor further issues of them. When the amount outstanding was reduced by some $6 million early in 1866, the action met with criticism in some business circles.[34] When severe restrictions were placed by Congress on the contraction of greenbacks, the attention of financial observers turned to other aspects of debt management.

The certificates of indebtedness, like the compound-interest notes, were a favored form of security in business and financial circles. Many people felt that more could be negotiated to advantage and that, good commercial paper being scarce, as much as $100 million of them might remain outstanding. These 6-per-cent one-year certificates, maturing at different times, were especially attractive to the banks.[35] At the same time, the increasing amount of temporary deposits with the Treasury[36] and the large balance of coin which it held brought much criticism upon the Secretary, even from those who appreciated the conservatism of his general policy.[37]

But what was desirable from the point of view of bankers and businessmen was not, as McCulloch saw it, necessarily sound debt policy. Late in 1866 he bluntly expressed the stand which he had indicated at other times:

> . . . feeling sensible of the great responsibility of his position, the Secretary has deemed it safer and better for the country to act according to the dictates of his own judgment, carefully regarding the condition of the markets and of the treasury, rather than to take his direction from those who, however intelligent and able, were under no official obligations to the government, and might be less accurately advised in regard to the actual state of its financial affairs.[38]

Prevented by the Loan Act of 1866 from taking what he deemed to be "the first important step" toward resumption, the Secretary continued his endeavor to convert the interest-bearing notes into bonds and to reduce the debt. At the same time he made it a

[33] *Treasury Report,* 1865, p. 14.

[34] *Merchant's Magazine,* LIV (March, 1866), 230.

[35] *Commercial and Financial Chronicle,* I (Oct. 7, 1865), 449; II (March 3, 1866), 257; II (June 9, 1866), 705; and *Merchant's Magazine,* LIV (March, 1866), 229.

[36] The largest amount of temporary deposits was $149.5 million on June 12, 1866 (Bolles, *op. cit.,* p. 91).

[37] *Commercial and Financial Chronicle,* I (Oct. 7, 1865), 449; II (March 3, 1866), 257; *Merchant's Magazine,* LIII (Nov., 1865), 336; LIV (March, 1866), 230; LVI (March, 1867), 237; *Banker's Magazine,* XXI (Sept., 1866), 240.

[38] *Treasury Report,* 1866, p. 9.

part of his policy to maintain in the Treasury a large reserve of gold coin—a measure which he believed it his duty to employ in order "to keep the business of the country as steady as possible, while conducted on the uncertain basis of an irredeemable currency."[39] It was the opinion of the Comptroller of the Currency that all the interest-bearing legal-tender notes might be converted into bonds (thus eliminating one form of debt available as currency) without causing a financial stringency, for probably not 5 per cent of them were in active circulation. "It would be simply exchanging one security held as an investment for another."[40]

The course of conversion for some months after the passage of the Loan Act was hampered by two events in Europe. The London panic in May temporarily depressed the prices of American bonds in European markets, the five-twenties declining in the course of a month from 72¼ to 64 in terms of gold. Some European holdings were sold on American markets. The aftermath of the panic was brief, but scarcely had the financial community regained its balance when a demand for specie arose in Europe because of the war between Austria and Prussia.[41] The financial markets quickly recovered from these adverse influences, however, and it soon became apparent that the Treasury could push forward with its plans. In July the *Commercial and Financial Chronicle* referred to "considerable public anxiety"[42] with regard to the short-term debt, owing to the fact that within two years $1,000 million of the debt would mature. The article pointed to the strength of the markets in absorbing the bonds recently sold by Europeans. "Everyone conversant with Wall Street knows that gold-bearing bonds are extremely scarce"; "it is surely the part of wisdom to begin the issue as soon as we can."[43] With the restoration of confidence conversion moved forward rapidly.

Between August 31, 1865, and October 31, 1866, the following significant changes in the debt structure had taken place:[44]

Decrease in the short-term debt:

7.3 per-cent Treasury notes	$105,985,700.00
Certificates of indebtedness	84,911,000.00

[39] *Ibid.*

[40] *Report of the Comptroller of the Currency*, 1865, pp. 66-67.

[41] *Commercial and Financial Chronicle*, II (May 26, 1866), 642; III (July 7, 1866), 3-4.

[42] III (July 7, 1866), 2.

[43] *Ibid.*, III, 2-3.

[44] *Treasury Report*, 1866, pp. 6-7.

Compound-interest notes	68,512,020.00
Temporary loan	62,146,714.27
5-per-cent Treasury notes	31,000,000.00
United States notes (greenbacks)	42,830,174.00

Increase in the funded debt:

6-per-cent five-twenty bonds authorized by the Loan Acts of March 3, 1865, and April 12, 1866	$205,281,000.00
6-per-cent bonds of earlier authorizations	12,208,250.00

Various other debt items which increased or decreased were of minor amounts. During this period the net debt decreased by $206,379,565.71.[45]

The principal loan instrument by which the conversion operations were carried out, as has been seen, was the five-twenty 6-per-cent bond. Another, but minor, obligation employed for conversion was the 3-per-cent certificate which was authorized by the Act of March 2, 1867,[46] in which the Secretary was directed to issue $50 million of these certificates to be used for the redemption and retirement of compound-interest notes. In October and December of that year $11,560,000 of these certificates were issued to redeem compound-interest notes then maturing,[47] and the remainder of the issue was subsequently disposed of. The certificates were of indefinite maturity, were payable in lawful money on demand, and were eligible to be held by banks as a part of their reserves.

The issuance of these certificates was, of course, an advantage to the national banks, for as the compound-interest notes, which were also eligible for bank reserves, had been redeemed by the Treasury, legal-tender notes had taken their place as reserves, and thus the amount of currency in circulation was contracted. The employment by the banks of the new certificates rather than greenbacks to replace the redeemed compound-interest notes formerly held as reserves thus released greenbacks for circulation.

> The three per cent. certificates are a substitute, to a considerable extent, for United States notes, being largely held by the banks as a portion of their reserve, and thus indirectly, though not to their full nominal value, they swell the volume of currency.[48]

[45] *Ibid.*, 1866, p. 7.
[46] 14 Statutes 558.
[47] *Treasury Report*, 1867, p vi.
[48] *Ibid.*, 1869, p. xviii.

The real motive of Congress in authorizing these certificates was not so much to favor the banks as to check and neutralize the process of currency contraction[49] which had been put in operation just a year earlier.[50] Later, to remove the possibility of a stringent money market,[51] an additional $25 million of the certificates was provided for by the Act of July 25, 1868.[52] They were to be used for the retirement of the remaining compound-interest notes.[53] In the Act of July 12, 1870, provision was made for their redemption.[54]

The surprising rapidity with which the conversion bonds were disposed of in 1867 and 1868 is accounted for by two favorable circumstances. The first of these was the condition of the money market, which remained relatively stable under the watchful eye and powerful influence of Secretary McCulloch, who made it a part of his policy both to restrain speculative expansion of credit and to aid the market at times of stringency. The second was the fact that there were two outlets for the bonds. They could be exchanged for the 7.3-per-cent notes, the outstanding amount of which was very large; and they could be bought for cash at the publicly advertised price.[55] So long as the Secretary's control over the money market was successful, the conversion bonds commanded a premium which made them an attractive exchange for the 7.3's as those notes approached maturity.

By December, 1867, all of the temporary loans, the certificates of indebtedness, and the 5-per-cent notes (except for small amounts not presented for payment) had been paid. All that remained of the short-term interest-bearing debt was $71,875,040 of compound-interest notes and $337,978,800 of the 7.3-per-cent notes.[56] On July 15, 1868, the maturity date of the last of the 7.3's, the "task of converting a thousand millions of temporary obligations into a funded debt" was practically completed,[57] the remnant of compound-interest notes being redeemed within a few months thereafter.

[49] Blaine, *op. cit.*, II, 327.

[50] The Act of April 12, 1866 (14 Statutes 31) had provided that not more than $10 million of the greenbacks could be retired in the first six months following the passage of the act, and not more than four million in any one month thereafter. This permitted their gradual contraction.

[51] Jacob K. Upton, *Money in Politics* (Boston: D. Lothrop Co., 1884), p. 132.

[52] 15, Statutes 183.

[53] *Ibid.*

[54] 16 Statutes 251.

[55] *Commercial and Financial Chronicle*, V (Aug. 10, 1867), 165.

[56] *Treasury Report*, 1867, p. v.

[57] *Ibid.*, 1868, pp. xli, xliv.

Thus, by rearranging terms and maturities and eliminating a variety of issues, the debt was brought under control and its structure greatly simplified. The bulk, but not quite all, of the conversion had been into the 6-per-cent five-twenty bonds. Otherwise identical in their terms, they were issued as of four different dates and accordingly became redeemable at different times. Below is shown the way in which they were designated and certain details of their issuance.[58]

Designation	Date Redeemable	Amount Issued	Average Price at Which Sold
Five-twenties of 1865[59]	Nov. 1, 1870	$203,327,250	103.547
Consols of 1865	July 1, 1870	332,998,950	101.691
Consols of 1867	July 1, 1872	379,618,000	100.062
Consols of 1868	July 1, 1873	42,539,930	100.045

Threats of Repudiation

Although the Treasury could sell bonds at some premium in the home market, and thereby follow through to completion in 1868 the conversion of the floating debt, the paper currency continued at a substantial discount[60] and United States bonds sold at approximately the same discount in Europe. For some time after the war it seemed to Europeans that investments in United States securities should yield about 10 per cent interest.[61] This reflected the doubt in minds of investors as to the manner in which the government would pay its obligations. No clear provisions had been made in the loan authorizations that the bonds be paid in coin, although that was plainly the intent of the legislators and the understanding of those who bought the bonds.[62] The growing demand in Congress and among the people that the debt be paid in greenbacks (worth about 70 cents on the dollar) thus raised the threat that the vast

[58] *Ibid.*, 1914, p. 205.

[59] These were issued prior to passage of the Loan Act of 1866, but except for the dates when redeemable and payable they were identical with the subsequently issued Consols.

[60] In May, 1865, the average price of gold in greenbacks was 135.6; in Sept., 1869 it was 136.8. At times between these dates it ranged much higher. Wesley C. Mitchell, *Gold, Prices, and Wages Under the Greenback Standard* (Berkeley, Calif.: The University of California Press, 1908, pp. 13-14).

[61] Charles F. Speare, "Selling American Bonds in Europe," *Annals of the American Academy of Political and Social Science*, XXX (Sept., 1907), 271.

[62] For an analysis of the intent of Congress, see *Treasury Report*, 1867, pp. xxiv-xxvii.

amount of five-twenties which, by their tenor, were already redeemable or soon to become so, would simply be called and paid with freshly printed greenbacks.[63]

By 1868 the cleavage in public opinion with respect to the currency and the debt was so broad that the question became the major political issue in the elections that year. In July the Republican National Convention denounced "all forms of repudiation . . . and called for payment of all creditors . . . not only according to the letter, but to the spirit of the laws."[64] The Democratic National Convention demanded that unless a government obligation specified payment in coin it should be paid in greenbacks. It proposed one currency for bondholders as well as all other individuals.[65]

If the public credit could become a major issue in a presidential election, there was good reason for investors to be wary of the government's obligations, and for those who purchased them to do so at a discount commensurate with the risk. In spite of the favorable implications of Grant's election in November, the nation's credit

[63] *Ibid.*, pp. xxiii-xxix. In this annual report McCulloch dwelt at length, and eloquently, upon the necessity for payment of the bonds in coin, holding it to be the honorable and economical way of managing the debt. The United States was pledged to pay its debt "according to the understanding between the government and the subscribers to its loans at the time the subscriptions were solicited and obtained . . . .

"The bonds were negotiated with the definite understanding that they were payable in coin . . . . The contracts were made in good faith on both sides, a part of them when the government was in imminent peril and needed money to preserve its existence . . . . Good faith and public honor, which to a nation are of priceless worth, require that these contracts should be complied with in the spirit in which they were made . . . .

"National debts are subject to the moral law of the nations. Whenever there is no expression to the contrary, coin payments in such obligations are honorably implied" (*ibid.*, pp. xxiii, xxiv, xxvii).

Jay Cooke, who had taken so active and successful a part in placing the bonds with the public, was outraged at the thought that the government might be led to redeem its debt with a cheapened currency. In an open letter to the public he emphasized that "It is suicidal and foolish to thus damage our credit by attempting to force a construction of the Loan laws never contemplated by those who framed them, by those who executed them, nor by those who invested under their provisions." Even greater was his concern that he and his subagents, who had distributed many of the bonds, would have had a part in the "gross deception" of the people. To the newspaper editors of the country he said, "You, gentlemen of the press, are equally responsible . . . . You disseminated, in thousands of editorials, the statement that the funded debt (the 5-20 and other loans) were, principal and interest, payable in coin. You did it honestly, and so did I" ("Letter of Mr. Jay Cooke on the Payment in Gold of the U. S. Five-Twenty Bonds, to the Editor of the *Philadelphia Inquirer*," March 19, 1868).

[64] Charles F. Dunbar, "The Safety of the Legal Tender Paper," *Quarterly Journal of Economics*, XI (April, 1897), 228.

[65] Barrett, *op. cit.*, p. 169.

continued at a low level. The poor status of American government obligations in the world market is made emphatically clear by a comparison of the 6-per-cent five-twenties with the low-interest-rate bonds of certain European governments. In December, 1868, their prices were as follows:[66]

3-per-cent British Consols	92⅛
3-per-cent French Rentes	69½
2½-per-cent Dutch loan	57
6-per-cent United States five-twenties	74½

The Republican victory was reassuring, but the proposal a month later by President Johnson that sixteen years of interest payments should wipe out the debt[67] indicated to what extremes conception of debt policy could go in high places. Resolutions strongly condemning the proposal were passed by the Senate and the House by large majorities.[68] On March 18, 1869, Grant approved the "Act to Strengthen the Public Credit,"[69] a measure which stated definitely that the bonds of the government would be paid in coin.[70] This legislation, followed on July 14, 1870, by the Refunding Act, which clearly specified that all the bonds authorized by it be paid in coin, settled for a time one important aspect of the public-credit controversy.[71] The continuous reduction of the debt also tended to enhance the public credit.[72] Investors were reassured in spite of the fact that the ranks of the inflationists continued to grow.

The plain fact is that in this postwar period the credit of the United States was extremely poor. It was poor for one fundamental reason: a sufficiently large portion of the population did not comprehend or were misinformed as to the rudimentary nature

[66] *Bankers' Magazine,* XXIII (May, 1869), 906, 909.

[67] Richardson, *Messages and Papers of the Presidents,* VI, 678.

[68] *Congressional Globe,* 40th Cong., 3d Sess., Dec. 14, 17, 1868, pp. 71-73, 123-128.

[69] 16 Statutes 1.

[70] "It is evident . . . that this pledge and promise so solemnly given can never be recalled. . . . It enters into the essence of the contract and is binding upon both the parties . . ." (*Merchant's Magazine,* LX, March, 1869, 226).

[71] It is "wise statesmanship to declare a simple, a strong, and an honest policy, and to so interpret the contract that no doubt may exist respecting it, for then only can a people realize the full value of their debt upon exportation" (H. C. Adams, *Public Debts,* p. 182).

[72] *Merchant's Magazine,* LX (June, 1869), 402.

of money and credit.[73] There can be times when repudiation is justified, but this was not one of them. How much of the popular movement which so weakened confidence in the nation's credit can be ascribed to ignorance, how much to a low sense of the ethical, cannot be determined, but the times were conducive to both.[74] It must be said, of course, that one easily comes to believe in that particular policy which seems to serve best his immediate personal interest. It was an understandable human reaction of the farmer, for example, caught between heavy fixed-debt charges and declining prices for his produce, to rebel against debt and currency policies which threatened to ruin him. The evils of unsound war finance became more than ever apparent when measures were taken to correct them.

The Essential Soundness of the Conversion Policy

McCulloch's conversion of the enormous short-term debt into funded form in a relatively short period of time was a notable achievement. Throughout the operation he had exhibited remarkably sound judgment. The danger inherent in a large floating debt and the need to fund it while conditions were favorable made the conversion an undertaking of considerable urgency. At the same time, the unavoidably high rate of interest on the new obligations

[73] "They thought they wanted more currency; what they needed was more capital" (Hepburn, *History of Coinage and Currency*, p. 226).

[74] One observer of the trend toward currency inflation in the last third of the nineteenth century wrote, "The argument of the leaders, that our monetary embarrassments proceed from a scarcity of gold, doubtless represents fairly the honest conviction of the great body of the supporters of the movement" (William Brough, *The Natural Law of Money*, New York: G. P. Putnam's Sons, 1896, p. 146).

Another commented, "For the last thirteen years the moral sense of the people has been chloroformed by the circulation, as money, of about seven hundred millions of lies" (Elizur Wright, "The Relations of Debt and Money," *North American Review*, CXXIV, May, 1877, 433-434).

Walter Bagehot has pointed out that "There is a natural tendency in men to follow the example of the Government under which they live. The Government is the largest, most important, and most conspicuous entity with which the mass of any people are acquainted; its range of knowledge must always be infinitely greater than the average of their knowledge, and therefore, unless there is a conspicuous warning to the contrary, most men are inclined to think their Government right, and when they can, to do what it does" (*Lombard Street: A Description of the Money Market*, new ed.; New York: E. P. Duttton and Company, 1921, p. 93).

A more recent student of public debts has raised the broad question of "the natural repercussions of Debt upon character and attitudes, upon passions and political condition, upon morals and law, as well as upon the purely economic welfare of men" (Freeman Tilden, *A World in Debt*, New York: Funk & Wagnalls Company, 1936, p. 348).

and the fact that the annual interest payments on the debt were thereby temporarily increased[75] made the conversion seem to those who were unaware of the low state of the public credit much less of an achievement than it really was.

There is a consensus among students of finance that under favorable conditions conversion is a relatively simple undertaking. Often the high praise accorded a public financier for the achievement of so large an operation should justly be shared with his predecessors and contemporaries whose policies have resulted in the conditions favorable to it.[76] The feasibility of conversion, however, depends upon both the state of the money market and the strength of the public credit.[77] It may be said that the more urgent the need for this financial operation the more difficult the undertaking of it, for a large floating debt can be "a source of great danger," especially following a war, in that it weighs "more heavily on public credit than other forms of obligations."[78]

It has been observed that in a large floating debt there is latent the financial danger that a government may be pressed to pay large sums when it is not convenient to do so. Certain economic disadvantages also may develop as the result of an unwieldy short-term debt structure. By continual renewals such debt may come to appear permanent, banks may give preference to government bills, certificates, and notes over proper business loans, some form of inflation may develop, and the confidence of foreign bondholders may be so impaired that exchange rates and the flow of specie are adversely affected.[79]

Inability or unwillingness to bring the debt under control will raise the cost of borrowing either directly to the government or indirectly to the people. Where the situation is extreme, a government may find itself on the verge of bankruptcy. As it becomes more difficult for a government to obtain funds, it goes from taxation to borrowing and from borrowing to currency inflation.[80] Following a war there is the twofold problem of conversion and

[75] *Treasury Report,* 1946, p. 369.
[76] Adams, *Science of Finance,* p. 554.
[77] Cf. Adams, *Public Debts,* pp. 220, 238.
[78] *Ibid.,* p. 202.
[79] Shutaro Matsushita, *The Economic Effects of Public Debts* (New York: Columbia University Press, 1929), pp. 86-88; and William Withers, *The Retirement of National Debts* (New York: Columbia University Press, 1932), p. 39.
[80] Cf. Withers, *op. cit.,* p. 155 n.

payment. Revision of the debt structure through a sound policy of conversion gives control over the debt and may, through an improvement in public credit, make possible a reduction in the rate of interest. So far as a reduction in the debt takes place, other conditions remaining the same, the public credit is further strengthened. Depending upon the urgency of the need for conversion and the amount of interest-saving it may achieve, its part in reducing the debt burden is, of course, limited compared with that of actual repayment.[81]

Considerations such as these were set firmly in the mind of Secretary McCulloch as he developed his debt-management policies. He perceived that conversion of the floating debt would enhance the public credit, yet the public credit must first be strong enough to induce investors to accept the new obligations. Contraction of the greenbacks seemed to him an important and direct means to achieve these other two objectives. To him contraction was simply a part of the conversion operation. For all the emphasis which he placed upon this aspect of it, however, his view of the debt-management problem was comprehensive. His annual reports abound with references to the many forces in an economy which, in greater or less degree, bear upon the problem of the debt and must be recognized and weighed in the development of sound debt-management policy. In one way or another he related to it not only such primary matters as the structure and terms of the debt itself, the public credit, taxation, the currency, the banking system, and the money market, but also the distribution of the debt within the country, foreign ownership of it, private indebtedness, speculation, international trade and the balance of payments, economy in government, the democratic institutions of the country, national defense, development of the national resources, growth of population, crops, the degree of prosperity and business confidence, the price level, national income, even railroad subsidies, shipbuilding, and the rehabilitation of the South.[82]

This *Gestalt* sort of view of the debt in its relation to the government's general fiscal policy and to the whole economy was enlight-

[81] Cf. Edwin R. A. Seligman, *Studies in Public Finance* (New York: The Macmillan Co., 1925), pp. 204-205; Bastable, *op. cit.*, p. 705; Hugh Dalton, *Principles of Public Finance* (9th ed.; London: George Routledge & Sons, Ltd., 1936), pp. 287-288.

[82] *Treasury Report*, 1865-1868, *passim*.

ened and realistic. Professor Abbott has pointed out that all activities of government, in so far as they affect the volume of business activity, are, from a broad viewpoint, a part of debt policy.[83] Indeed, governmental activities and the level of business activity may be related to debt-management policies both as cause and as effect, all of the forces and conditions having a mutually determining influence upon one another.

[83] Charles Cortez Abbott, *Management of the Federal Debt* (New York: McGraw-Hill Book Company, Inc., 1946), p. 186.

CHAPTER VI

Refunding the Debt

Preparation for Refunding

THE DEBT having been funded into more manageable form, although at a high rate of interest, the next step was to refund it at lower rates. While the earlier operation had, in effect, brought about the exchange of short-term debt (notes, certificates, and temporary loans) for bonds, the refunding was also to be a conversion, but of bonds bearing certain rates and maturities into bonds of other rates and maturities. The terms "conversion" and "refunding," as used here, designate two quite separate undertakings, in the first of which short-term debt was changed into long-term debt, and in the second of which the form of the long-term debt was adapted to what was believed to be the greater advantage of the government.

Secretary Chase's policy of short-term financing, which had placed the Treasury in a vulnerable position and to some degree had weakened the public credit during the years immediately following the war, yielded a better result once the way was cleared to deal with the wartime bond issues. Most of them were short-term too, but of such a nature that they did not press upon the Treasury for redemption. The five-twenties were redeemable after five years and payable in twenty years. In 1869 three-fourths of the interest-bearing debt was in this form and was either then redeemable or soon to become so.[1]

This form of "limited option" debt was an innovation of Civil War finance which had become known in Europe as the "American system."[2] Its advantage to the government is apparent, for such bonds could be paid at its pleasure after five years. Something of

[1] *Treasury Report*, 1869, p. xvi. [2] Adams, *Public Debts*, p. 162.

a disadvantage, however, was the fact that they were not the most desirable type of security for those investors who preferred longer maturities, even at lower rates.[3] Such investors became numerous in the latter part of the war, when money was plentiful, yet the interest yield on government bonds remained very high. It was perceived that the longer the term of a bond bearing a high rate of interest the more the bond would appreciate in value as the nation recovered from war, as its credit was restored, and as, consequently, the rate of interest declined. Because of investor preference based upon this future prospect, the government was obliged to pay a somewhat higher rate of interest on bonds that it might call in at its pleasure after five years. In this is seen the explanation for the prevailing graduation of interest rates from higher to lower yields the longer the maturity. It was exactly the opposite of the modern interest-rate structure and was due to a general anticipation that the rate of interest in the money market would eventually decline. But whatever the extra cost to the government in interest charges, the advantage which the five-twenties gave for refunding at later times at much lower rates, as well as the advantage in being able to reduce the principal of the debt as surplus revenues permitted, was worth far more simply in terms of dollars saved.

A refunding bill had been proposed in the Senate in February, 1868, and had been elaborately debated, almost every senator participating. It "was conceded to be the most comprehensive and instructive debate on financial questions for many years." On July 14 the bill passed the Senate, and soon thereafter, with amendments, it passed the House. A conference committee then reported a modified version which passed both houses and went to the President. Since it was late in the session, however, the President's failure to approve the bill prevented it from becoming law. No further attempt was made to enact a refunding measure during

[3] During the nineteenth and into the twentieth century there was a marked preference for long-term government bonds, even at interest rates below those of shorter-term obligations. Instances illustrating this appear at various points in this study. Henry C. Adams, who was writing on subjects of finance in the last third of the nineteenth century, observed, "Investors always prefer bonds of long life . . ." He believed that if the debt were in rapid process of repayment, it might "be wise to effect a large immediate saving upon part of the debt, by granting a long guarantee, for the purpose of securing additional funds with which to carry on the policy of debt-payment upon the high-priced bonds." He did not approve, however, of the 30-year 4-per-cent Refunding Loan of 1877 (*Public Debts,* pp. 172, 234-235).

Johnson's administration, for the rift between him and Congress almost assured the veto of any legislation which that body might favor.[4]

The status of the interest-bearing part of the debt, with regard to its maturity and redeemability and its amount, on December 1, 1869, was as follows:[5]

Issues Redeemable or Payable	Interest Rate (Per cent)	Amount
All of the five-twenties, issued between 1862 and 1868, the latest of which would become redeemable July 1, 1873	6	$1,602,671,100[6]
Loan of January 1, 1861, payable January 1, 1871	6	7,022,000
Loan of 1858, payable January 1, 1874	5	20,000,000
Ten-forties of 1864, redeemable March 1, 1874	5	194,567,300
Various loans, all becoming payable or redeemable between December 31, 1880, and July 1, 1881	6	283,677,600

From this it may be seen that the refunding operations contemplated in 1869[7] and authorized by legislation in 1870[8] were solely concerned with the five-twenties, for, until March 1, 1874, only a relatively small amount of other bonds would fall due, and it was assumed that they would be paid from surplus revenues.

Secretary Boutwell, foreseeing surplus revenues and contemplating substantial annual reductions in the debt, suggested that the refunding authorization be made for only $1,000 million, or $1,200 million at the most, so that a considerable amount of the five-twenties might be available for purchase or redemption, along with the outstanding ten-forties, in the period before the 1881 maturities. He estimated that some $60 million a year might thus be paid off.[9] He had recommended to Congress late in 1869 that if so much as $1,200 million was authorized for refunding, this amount should be divided by maturities into three classes of $400 million each, the first

[4] Sherman, *Recollections*, I, 439-441.

[5] Data derived from *Treasury Reports*, 1869, p. xvi; 1880, p. x; and 1914, pp. 201-205.

[6] About $75 million of these had already been purchased and were held in the Treasury at this time.

[7] *Treasury Report*, 1869, pp. xvi-xviii.

[8] Act of July 14, 1870, 16 Statutes 272.

[9] *Treasury Report*, 1869, pp. xvi-xvii.

to be redeemable in 15 years and payable in 20 years, the second to be redeemable in 20 years and payable in 25 years, and the third to be redeemable in 25 years and payable in 30 years. Various other provisions were suggested by the Secretary.[10] A year before, McCulloch had proposed that enough bonds be authorized to refund all the outstanding 6-per-cent obligations and that $500 million of the new authorization should mature at the rate of $50 million annually, principal and interest to be payable in lawful money; that the remainder of the loan should be redeemable in ten years and payable in thirty, interest and principal to be paid in coin.[11]

Both plans contemplated substantial debt reduction each year, and both looked to the enhancement thereby of the public credit.[12] Boutwell's plan, however, allowed more flexibility in the management of the debt, for, although he had in view large annual payments, it did not make them a necessity, as the proposed annual maturities of McCulloch's plan would have done. In the light of after events which neither secretary could have foreseen, it is apparent that annual maturities during the panic year and the depression would have been extremely burdensome.

Provisions of the Loan Act of 1870

The Loan Act of July 14, 1870,[13] embodied most of the features of Boutwell's proposal, although it changed the maturity terms of the three proposed issues. The bill, as reported out of committee by Senator Sherman, was, according to Boutwell,[14] as the Secretary had drawn it.[15] It occasioned considerable debate in the Senate, and some in the House.[16] Except in a few particulars, its final form did not differ greatly from Boutwell's recommendations. He had especially desired that interest on the bonds be made payable in Europe, but this was not done.[17] A more important change was

[10] *Ibid.*, p. xvii.

[11] *Ibid.*, 1868, p. xxii.

[12] *Ibid.*, p. xxiii; Boutwell, *Reminiscences*, II, 140 ff.

[13] 16 Statutes 272.

[14] Boutwell, *op. cit.*, II, 140-142.

[15] The bill had first been introduced in the Senate by Charles Sumner, of Massachusetts, but it was reported from committee with an amendment in the nature of a substitute. It was to this latter form that Boutwell made reference (*Congressional Globe*, 41st Cong., 2d Sess., Jan. 11, 12, 1870; Feb. 3, 1870, pp. 348, 378, 992).

[16] *Ibid.*, Feb. 3, 24, 28; March 2, 3, 8, 11; June 30; July 1, 1870; pp. 992, 1536-1542, 1586-1594; 1627-1634, 1653-1664, 1755-1762, 1859-1884; 5018-5026; 5055-5071.

[17] When in Congress he had vigorously urged this same provision during debate on the earlier refunding bill (*ibid.*, 40th Cong., 2d Sess., July 21, 1868, pp. 4296-4297).

the provision that the longest maturity be redeemable after thirty years.

The amounts and kinds of bonds authorized were as follows:

$200 million at 5 per cent, redeemable after 10 years.[18]
300 million at 4½ per cent, redeemable after 15 years.
1,000 million at 4 per cent, redeemable after 30 years.

Two provisions of this legislation new in Federal financing were that the principal and interest be "payable in coin of the standard value of the United States, July 14, 1870," and that principal and interest be exempt from all Federal, as well as state and local, taxation.[19]

The use of the term "coin" rather than "gold" had the effect, later on, of subjecting this provision of the act to two interpretations. When gold attained a premium over silver, those who favored the latter metal were to argue that the bonds might be paid in either. That the word "coin" had been substituted for the word "gold" when the bill was under consideration gave some validity to this claim. But those who argued for silver ignored the generally accepted meaning of the term "coin" at the time the bill was passed. To those who bought the bonds the term signified gold.

As an inducement to investors to subscribe promptly to the refunding bonds, the act provided that payment of the bonds when they became due was to be made in order of dates and numbers, beginning with each class last dated and numbered. This meant that the first bonds subscribed would be paid last. Since at this time bonds of longer term were considered the more desirable, it was intended that the earlier subscribers should receive a somewhat more valuable bond.[20]

Other provisions of the act were that the debt must not be increased, the bonds must be sold at par or better or be exchanged at par for the five-twenties, the interest on called five-twenties was to cease three months after notice of call, and certain requirements

[18] The Act of Jan. 20, 1871, amending this enactment, simply allowed the issuance of $500 million of 5-per-cent bonds instead of the $200 million, but did not permit an increase in the total authorization. It also authorized the quarterly payment of interest (16 Statutes 399).

[19] 16 Statutes 272; and William A. Richardson, *Practical Information Concerning the Public Debt of the United States* (2d ed.; Washington: W. H. & O. H. Morrison, 1873), p. 11.

[20] " . . . the difficulty of placing a new loan is always at the start; after a loan is well advertised it will run itself" (Adams, *Public Debts*, p. 237).

must be met for the destruction of bonds acquired through operation of the sinking fund.

A highly important aspect of this loan enactment was the length of time which the three issues authorized by it would be outstanding before they might be redeemed. The 5's were redeemable in 10 years, the 4½'s in 15 years, and the 4's in 30 years. They could not be called in sooner either at par or at some stated premium. The only way in which their amount could be reduced before their terms had run was through direct purchase at whatever price the market might command. As finally issued during the long period of refunding,[21] the 4 per cents, which were much the greater part of them and which also had by far the longest term to run, were the last to be offered. As it eventuated, the three issues were to become redeemable as follows:[22]

Issue	*When Redeemable*	*Amount*
The 5-per-cent issue	May 1, 1881	$517,994,150
The 4½-per-cent issue	September 1, 1891	250,000,000
The 4-per-cent issue	July 1, 1907	740,930,950

A Major Error in Debt Policy

Again the Treasury was to lose control over a large part of the debt, and, ironically, in a way the very opposite of that which Chase's policies had brought about. Instead of a great amount of floating debt which might at any time threaten the solvency of the government, now a huge portion was to be placed out of reach so that for a generation it could not be called or redeemed, no matter how great the surplus of revenues or how firm the determination to reduce the debt. This "freezing" of the debt was done at what proved to be a high rate of interest. Whatever it may have contributed to the perpetuation of a high tariff system will perhaps always be a question, but certainly it lengthened the life of an awkward and inadequate banking and currency system. In simplest terms of money flow, it sluiced a considerable amount of income

[21] By authority granted in later amendments to the original loan act, a part of the 4 per cents and 4½ per cents was issued to obtain specie in preparation for resumption (18 Statutes pt. 3, 296). Some of the 5 per cents were issued under an authorization permitting their use to provide funds for widening and deepening the channel "between the South Pass of the Mississippi River and the Gulf of Mexico" (*ibid.*, 466). Another use made of the 5 per cents was their exchange, at the option of the holders, for bonds of the loan of 1858, which came due Jan. 1, 1874 (*ibid.*, 1).

[22] *Treasury Report*, 1914, pp. 206-208.

from those who paid the taxes (in large part customs duties passed on to consumers) to those who directly or indirectly held bonds bearing an unwarrantedly high rate of interest.

At this time it was considered the duty of Congress to determine the interest rates and maturities of the government's obligations. It had always been the custom for the legislative body to decide these terms, and not to leave them to the discretion of the Secretary of the Treasury. Only much later were such matters entrusted to his judgment. The need both for flexibility and for highly technical decisions in designing Treasury issues to meet changing requirements of the loan markets was eventually to be recognized when these powers, with few restrictions, were placed in the secretary's hands. But in the post-Civil War period this responsibility rested with Congress. By what steps that body, in 1870, came to settle upon the authorization of $1,000 million in thirty-year refunding bonds is of considerable interest.

More than one element of motivation lay behind the action which resulted in this long-term issue.[23] At the time the legislation was debated in Congress it was realized that even a 5-per-cent bond would be difficult to sell. Yet the purpose of refunding was to reduce the interest burden. It seemed logical to suggest that in order to make the new bonds attractive to investors at a lower interest rate Congress must provide what they so much desired and

[23] Henry C. Adams, writing about the year 1885, took a strong stand against such long-term financing and attempted to account for its occurrence in refunding operations partly in terms of human nature: " . . . no government should contract itself out of the right to make a further conversion at some future time in order to secure a slight immediate reduction in the interest-payments . . . .

"The administration should assent to no plan of conversion by which the policy of debt payment may be embarrassed" (*Public Debts,* pp. 224-225).

"Perhaps there is no temptation presented to the financier so alluring as that which leads him to sacrifice control over a debt for a slight though an immediate reduction in the annual payment for interest . . . . He sees that, by granting a guarantee against new conversion for twenty or thirty years, he can yet further reduce the immediate burden of the debt, and the greater the reduction the greater will be his popular reputation. Few men can withstand such a temptation, but it is against this choice that sound financial principles utter their strongest protest" (*ibid.,* p. 227).

In a later work Adams pointed out that "the policy of debt payment should be formulated at the time the debt is thrown into its definite shape, which means that both the funding of floating obligations and the process of conversion, which inevitably follow the creation of a debt under the stress of an exigency, should be so carried through as to bring the debt into shape for orderly and uniform payment. There is no other single act in connection with this branch of financiering that calls for so high a grade of business judgment" (*The Science of Finance,* 1898, p. 564).

would pay for, namely, a long-term bond. This argument was repeated throughout the debates, during which the extreme proposal was made by Senator Wilson that the bonds run for as long as fifty years.[24] To this Senator Sherman objected with vehemence:

> . . . never, from the foundation of our Government to this hour, did the United States issue a bond under any circumstances that was not at the pleasure of the United States to redeem after twenty years, and mostly after fifteen years.[25]

But Sherman, like other of his colleagues, felt that the proposed rates of interest were too low. His words indicate that he did not believe bonds bearing less than 5 per cent could be negotiated within the foreseeable future.

> The only fear I have as to the success of this measure is on account of the rate of interest fixed. I should be very glad, indeed, to see our whole debt funded at five per cent., but the Secretary of the Treasury is of the opinion that he can negotiate bonds bearing a less rate of interest for a portion of the public debt. If he can I hope he will.[26]

Senator Morrill, also doubting that bonds could be sold at less than 5 per cent, suspected that the political opponents of the administration would vote for the low rates in order to see the project fail.[27] It was Sherman who pointed out that the tasks of Chase, Fessenden, and McCulloch in selling bonds at par for greenbacks was much easier than that of "selling $1,200,000 bonds bearing a much lower rate of interest for gold at par."[28]

Another motive underlying the drive for a long maturity date was the desire on the part of some to reduce taxes. In the debates Sherman had said, "Taxes must be reduced; the payment of the national debt must be left in part to posterity." And Senator Sumner, also appealing for lower taxes, declared, ". . . the pending measure sacrifices the present."[29]

The perpetuation of the national banking system and its circulation privilege was another reason given for a long-term bond. Sumner made the clearest statement of this view when he said:

[24] *Congressional Globe,* 41st Cong., 2d Sess., March 11, 1870, p. 1860.
[25] *Ibid.*
[26] *Ibid.,* Feb. 28, 1870, p. 1591.
[27] *Ibid.,* March 3, 1870, pp. 1653-1657.
[28] *Ibid.,* March 8, 1870, p. 1756.
[29] *Ibid.,* March 2, 1870, pp. 1627-1630.

. . . the whole system of national banks is founded upon the bonds of the nation, so that at the rate of liquidation now adopted for the national debt the system will be without support in the lapse of twelve or fifteen years. The stability of the banks, which is so vital alike to the national currency and to the pecuniary interests involved in the business, can be assured only by an issue of bonds for a longer term. Of course, the longer the period the more valuable the bond.[30]

Secretary Boutwell, for all his zeal in reducing the debt, in a considerable measure shared this view. This was revealed when, not long after the passage of the Refunding Act, he proposed that Congress authorize 4-per-cent fifty-year bonds and require the national banks, on pain of losing their charters, to accept them in exchange for the bonds then held to secure their note circulation.[31] Against the vigorous hostility of the bankers which this highhanded proposal engendered, Boutwell attempted to justify himself by declaring that he had endeavored to perpetuate the national banking system. In his memoirs he wrote:

I had early foreseen that the Public Debt could be paid without much delay. . . . I predicted also that these payments would menace the national banking system. My scheme looked for the perpetuation of that system for fifty years at least. . . . At that time the capital of all the national banks was limited to three hundred million dollars. Thus did the banks defeat a measure which was designed to secure their perpetuity and calculated to promote their financial interests. They acted upon the idea that the credit of the country could never be so advanced that a four per cent bond would be worth par.[32]

Actually, he believed that $800 million of the debt—approximately one-third of it at that time—might be perpetuated for currency purposes:

Should the present system of furnishing a paper circulation for the country, partly by the Treasury and partly by the national banks, be continued, or the entire circulation be furnished by the Treasury, or by the banks . . . about $800,000,000 of the public debt will remain unpaid, existing either in the form of treasury notes in circulation with-

[30] *Ibid.*, Jan. 12, 1870, p. 380.

[31] Boutwell, *op. cit.*, II, 142. In his original refunding proposal, Boutwell had suggested that the banks be compelled to exchange old bonds for new or lose their charters. He did not, however, then favor a fifty-year maturity (*Treasury Report*, 1869, p. xviii).

[32] Boutwell, *op. cit.*, II, 143.

out interest, or in bonds owned by the banks and held as security for the redemption of their notes, and that only about $1,600,000,000 of the principal of the debt is subject to payment.[33]

Perhaps to Boutwell 4 per cent was the lowest rate the government might expect to pay for many years; perhaps $300 million of bonds securing national-bank-note circulation seemed to him a negligible part of the debt and might properly be rendered irredeemable for half a century; no doubt he valued highly the national banking system of note issue and did not envisage a better one. Yet his justification of the proposal was inconsistent with the energetic drive which he made to reduce the debt by every means within his authority, including the compound-interest process of the sinking fund. More than once he had repeated the sentiments expressed in his Report of 1870:

> Whatever arguments may be adduced, or whatever theories advanced, the fact must ever remain that a public debt is a public evil. It is especially burdensome to the laboring classes, and it is, therefore, in their interest to provide for the constant reduction of the existing national debt.[34]

Boutwell's earlier proposals bearing on the refunding legislation had not gone beyond a twenty-five-year period, and this for only a third of the total proposed authorization.[35] The bill which had passed the Senate had divided the loans into three maturities of 10, 15, and 20 years.[36] It was in the House that demand was strongest for the long-term issue. There a bill offered as a substitute for the one passed by the Senate simply provided for an issue of $1,000 million at 4 per cent, redeemable after 30 years. Robert C. Schenck, Chairman of the Ways and Means Committee, pointed out that this provision was intended "to make those bonds acceptable to capitalists at home and abroad."[37] Three amendments changing the time or redeemability were proposed and defeated.

[33] *Treasury Report,* 1870, pp. xv-xvi.

[34] *Ibid.,* p. xvi.

During the debate in 1868 on the refunding bill which failed for want of the President's signature, Boutwell had vehemently opposed a provision that part of the debt mature in forty years. He had said, "We must keep the loan so that we can control it ourselves—pay it when we choose" (*Congressional Globe,* 40th Cong., 2d Sess., July 21, 1868, p. 4297).

[35] *Treasury Report,* 1869, p. xvii.

[36] Sherman, *op. cit.,* I, 452.

[37] *Congressional Globe,* 41st Cong., 2d Sess., June 30, 1870, p. 5018.

One sought to make it 20 years; another 50 years. The third was proposed by a Mr. Van Trump, whose motion to make it 1000 years was received with laughter.[38]

The bill readily passed the House and went to a conference committee, where, after a number of meetings, a compromise of a sort was reached. The $1,000 million thirty-year 4-per-cent bonds were authorized; and in addition to them $200 million of 5 per cents and $300 million of 4½ per cents, redeemable after 10 and 15 years respectively.[39]

In many respects the Refunding Act had merit, for most of its provisions were sound, and it did much to bolster the public credit. But the amount and terms of the 4-per-cent issue which it authorized were the epitome of poor debt-management policy and short-sighted financial statesmanship.[40] Senator Sherman, who served on the conference committee which determined the final form of the bill, perceived the weakness of the legislation. In his memoirs he wrote of it somewhat philosophically:

> . . . it was compromise which, like many other compromises, was in its results an injury of great magnitude, but it was an honest difference of opinion between the Senate and the House, in which, tested by the march of time, the Senate was right and the House was wrong. But it was perfectly manifest that without this concession by the Senate to the House, the bill could not have passed . . . .
>
> . . . . . .
>
> And thus thirty-year securities, subsequently at a premium of more than twenty-five per cent., were forced into the law by the determined action of the House.
>
> This proved to be an error.[41]

This unfortunate provision of the act, by which, in effect, the government surrendered control over a large part of the debt for many years, can hardly be excused with the comment that "hind-

[38] *Ibid.*, p. 5025.

[39] Sherman, *op. cit.*, I, 452-453.

[40] "This legislation was extremely unfortunate for the government. In the years from 1887 to 1891 there was abundant revenue available for reduction of the public debt, but no obligations of the government were available for redemption. It became necessary to purchase those bonds which were not payable until the expiration of thirty years. In all, more than $50,000,000 of premiums were paid, the rate of premium in some instances reaching as high a figure as 29%" (Theodore E. Burton, *John Sherman*, New York: Houghton, Mifflin and Company, 1906, p. 207).

[41] Sherman, *op. cit.*, I, 453-454.

sight is better than foresight." At the time, it is true, a rate less than 4 per cent was hardly imagined, but no imagination or foresight was needed to perceive that in issuing a thirty-year bond there was tossed away a highly important prerogative. By doing this the government gave up a valuable option which would have enabled it, within a reasonable time, again to refund the debt to advantage. Sherman's argument that the concession made to the House was necessary if the bill was to pass overlooked the question whether it should have passed at all with such a provision. Refunding at lower rates had, certainly, been long delayed, but the time was not especially propitious for its undertaking. There was no urgency in the matter, for the conversion operations under McCulloch had placed the debt, at the option of the government, on a long-term basis.

Refunding legislation might well have been delayed, even for some length of time, at little loss to the government, for a broad market even for the 5-per-cent issue plainly did not exist when the bill was under consideration. Expert opinion in Congress[42] and elsewhere perceived this.[43] The five-twenties—which bore 6 per cent—in February, 1870, had come close to par, in terms of gold, in Europe. By May they had declined to 88.[44] So slow was the sale of the new bonds after the passage of the act that the 5-per-

[42] See above.

[43] The *Nation* noted that although the 6-per-cent bonds of the United States were selling to yield 7 per cent in England and Holland, the Treasury expected to sell nearly a billion and a half bonds paying 4 to 5 per cent. X (Jan. 27, 1870), 53.

The London *Economist* dryly commented, " . . . when the American government has to pay 6 per cent. for its money, Mr. Boutwell simply offers 1 to 2 per cent. less, and expects that the public will supply him with the money—the only advantage being that the new bonds will be irredeemable for specified terms. It is easy to predict immediate failure" (XXVIII, Nov. 5, 1870, 1342).

The *Commercial and Financial Chronicle* had opposed the refunding proposition for various reasons. It expressed the belief that the agitation which its discussion produced endangers "the financial prosperity of the country," the bill was "too complex," it threatened "changes in banks and banking," and "it disturbs the currency system of the country." It condemned the bill especially for the reason that it aimed at "an object which many men of experience deem incapable of accomplishment in the way and at the time proposed. At an immense expense during Mr. McCulloch's Secretaryship, the debt was funded in its present form, and in that form it ought to remain for some time to come." " . . . any attempt to put the debt in a permanent form before that credit is finally established, and the present growth of it fully matured, would be premature and injurious." X (Feb. 19, June 4, 1870), 229, 709-711.

[44] *Commercial and Financial Chronicle,* X (Feb. 26, May 14, 1870), 262, 614.

cent issue, which was offered first, was not entirely disposed of until 1876.[45]

In the Treasury Department the obsession that a very long-term bond was the most desirable for refunding purposes continued for some years after passage of the Refunding Act. In his annual report of 1875 Secretary Bristow, who was in many respects an able financier, took occasion to comment on the improved public credit and the favorable progress of refunding. Yet he immediately followed this with the proposal that the Refunding Act be amended so that the 4½-per-cent bonds (to be redeemable 15 years after date of their issue) be made redeemable "30 years from the date of their issue." The only reason which he gave for such a proposal was that because "little inducement is offered in the amount allowed as commissions for placing the United States loans, compared with that paid by other governments, it is thought important to give these bonds all the elements of popularity that may be possible."[46]

A somewhat more justifiable proposal, which also envisaged the issue of a thirty-year bond, was made by Secretary Morrill in 1876 in connection with his reflections on the problem of preparing for resumption of specie payments. He recommended that the resumption legislation should give the Secretary authority to fund the greenbacks into "a bond bearing a rate of interest not more than four and one-half per cent., with not less than thirty years to run."[47]

Some Conjectures

What the real forces were which brought about this major error in the management of the debt, or the conditions which permitted it, can only be conjectured. It was not the will of the people, and it does not appear to have been furthered to any great extent by pressure from bankers and conservative investors who stood to benefit from it. In fact, the provision for a thirty-year bond was insisted upon by the House of Representatives—a body far less sympathetic to the desires of vested financial interests than the Senate. The reasons advanced to justify it—a lower interest rate,

[45] Worthington C. Ford, "Refunding of the Public Debt of the United States," *Cyclopaedia of Political Science, Political Economy, and of the Political History of the United States,* John J. Lalor, ed. (Chicago: Rand, McNally & Co., and Melbert B. Cary & Co., 1881-1884), III, 560-561.

[46] *Treasury Report,* 1875, pp. xi-xii.

[47] *Ibid.,* 1876, p. xv.

tax reduction, perpetuation of national-bank-note circulation—appear to have been insufficient or specious.

In a negative way Sherman might be held responsible for the final passage of the act, in that its terms did not represent his own convictions. As the Senate's leader in matters of finance, and as one of the three Senate conferees who compromised with the conferees of the House on the bill, he might have let it be defeated. Simply to secure its passage, however, he acquiesced to terms much like those to which he had vigorously objected in the Senate debate. It was as if he were willing to see adopted almost any kind of refunding measure rather than none.

Though Sherman's influence might have prevented passage of the bill, nevertheless the enactment represented the will of Congress. Few in that body were versed in financial matters. Many, doubtless, did not comprehend the import of the legislation, or were swayed by the overemphasis of its currency aspects. The conversion of the debt into five-twenties at a high interest rate appears to have left the impression that a radically different type of obligation should be tried. The high conversion rate was attributed to the type of obligation rather than to the condition of the money market and the state of the public credit.

Certainly, both for members of Congress and for the people at large, this was a period of muddled and contradictory thinking, not only in financial matters but in political and ethical matters as well.[48] The reversal of debt policy from that of short-term redeemability, controllability, and eventual expungement to the very opposite of these was but one of many anomalies and inconsistencies of the time. It had its counterpart in such phenomena as the resolution of Congress to return to specie payments at an early date and its long delay in taking measures to do so; the turn from gradual currency contraction to measures of actual inflation; Johnson's departure from earlier-expressed principles when he advocated repudiation; Boutwell's desire to pay the debt and yet perpetuate it; Grant's inclination toward currency expansion and his turnabout in vetoing the inflation bill; the campaign to make "coin" bonds payable in greenbacks; the unwillingness of Congress to define the

[48] This trend in American politics was early recognized by the London *Economist*: "The appetite for political compromise among the managers of political sections in America is so keen, that principles vanish like smoke before the vision of a new combination." XXIV (Sept. 8, 1866), 1050.

term "coin" in the Refunding Act; the vacillations of Boutwell and Richardson in issuing and redeeming the greenbacks. These phenomena were typical of the period. There was lack of consistency, lack of comprehension, lack of vision, lack of character, and often lack of principle.

It was a bewildered era, and a vicious one as well. This was the time of the intolerant, oppressive, and vengeful policy of reconstruction in the South. It was the time also of widespread corruption in Congress, the courts, and various of the government departments. A President was impeached for political purposes. The great gold conspiracy which culminated in Black Friday, and the exposure of the whiskey ring, sullied the character of officials and private citizens alike. Dishonest speculation and dishonest finance were everywhere rife.[49]

It is little wonder that principle and policy were confused, and compromise was easily justified. So far as a major portion of the debt was concerned a short-sighted policy which overlooked the possibility of changing conditions and the need for flexibility in debt management permitted its unwarranted and uneconomical extension for a third of a century.

The Refunding Operations

SALE OF THE 5-PER-CENT LOAN

Although the Refunding Act was passed in July, 1870, no bonds were issued under the authorization until March of the follow-

[49] "Socially, financially, and politically, it stands out quite apart from any other decade of the century . . . . Moral sense seemed for a time to have deteriorated in the whole community . . . . The Government's financial recklessness was readily imitated by the community at large; debt was the order of the day in the affairs of both" (Noyes, *Forty Years*, pp. 17-18).

"The festering corruptions of the post-war period sprang up in every part of America and in almost every department of national life . . . . the Grant era stands unique in the comprehensiveness of its rascality . . . " (Allan Nevins, *Hamilton Fish: The Inner History of the Grant Administration*, New York: Dodd, Mead & Co., 1936, p. 638). Reprinted by permission of the publishers.

"These years reveal an unsteadiness of purpose, an ignorance of fundamental economic conceptions, and a willingness to subordinate public welfare to private advantage which are disheartening and revolting" (Barrett, *The Greenbacks*, p. 180).

"For some years the frauds and immoralities of the postwar boom years had been rising, as it were, to the surface of politics and obtruding themselves on the public view . . . . [There] were disclosures of corruption and of low official morality which excited the interest and indignation of even a postwar electorate" (Lucius Wilmerding, Jr., *The Spending Power: A History of the Efforts of Congress to Control Expenditures*, New Haven, Conn.: Yale University Press, 1943, p. 225).

ing year.[50] The European demand for funds which resulted from the war between France and Prussia had, for the time, made negotiation of the new bonds impracticable. This was another instance in which delay had unfortunate consequences for the Treasury. As has been pointed out, the five-twenties were selling close to par in Europe in February, 1870. Because of the extended term of the refunding 5's and the possibility of a call for a part of the old five-twenty 6 per cents, the new bonds were probably sufficiently attractive at that moment to induce a considerable amount of buying.

The refunding bill had been introduced in the Senate on January 11 and was passed by that body on March 11. On that date it was sent to the House, where it "slept for nearly three months without any action."[51] It was finally passed by both Houses on July 14. It seems that the chairman of the House Ways and Means Committee, Robert C. Schenck, had recently returned from Europe when Congress convened. In the course of his travels he had formed the conviction that the refunding loan could be negotiated at 4 or 4½ per cent.

> . . . it was this opinion on his part which led to delays. The bill was not passed until July 1870, at the very moment when the Franco-Prussian War opened. Had the bill been passed in March, quite large negotiations could have been made in April of that year.[52]

Early in 1870 it was plain that there were many strong factors to support the public credit. Congress had confirmed payment of the debt in coin and had condemned President Johnson's proposal for repudiation, the wealth of the country was rapidly increasing, all national obligations had been met promptly, each year saw a large Treasury surplus, and every Northern State was reducing its indebtedness. Yet the government's bonds were selling in European markets at a 7-per-cent yield.[53] The *Nation* raised the question why "American securities stand lower in the money markets of the world than those of any other power, except Turkey and Egypt . . . lower than even those of the Argentine Republic."[54]

[50] *Treasury Report,* 1871, p. xvii.
[51] Sherman, *op. cit.,* I, 452.
[52] Boutwell, *op. cit.,* II, 142.
[53] *Nation,* X (Jan. 27, 1870), 53. About this time the yield on British consols was 3.2 per cent and on French *rentes* 4.5 per cent. (*Commercial and Financial Chronicle,* X, June 4, 1870, 710).
[54] *Nation,* X, 52-53.

Transitory events like the Erie scandals and the inept negotiation of the *Alabama* claim, which was disturbing to Anglo-American relations, were of some significance for the moment. But more important was the attitude of some members of Congress, who showed that they did "not consider the public creditor a person deserving of much consideration."[55]

Although Boutwell was confident that the 5 per cents could be sold as conditions improved, he perceived that the 4½ per cents had little chance of being taken by investors for some time to come. Accordingly, he proposed to Congress that the authorization of 5 per cents be increased from $200 million to $500 million and that quarterly payment of interest be permitted.[56] On January 20, 1871, the Refunding Act was amended to meet these requirements.[57]

The refunding program was off to a slow start. Upon the outbreak of the Franco-Prussian War, Boutwell decided that nothing would be done until European affairs became more settled. No effort was made to sell the bonds until March, 1871, when the Treasury opened its books for subscription. With the assistance of Jay Cooke & Company and various banking firms associated with them some sales were then made. But the larger established banking houses in Europe and America remained indifferent to the refunding issue, either declining or neglecting to further the sale of it. The arrangement made by Cooke was such that almost any banking firm in the United States could participate in the offering. This made participation by important firms unattractive, as it did not pay them to take an active interest in the sale. The offering did not go well, and between March and August only $65 million were sold, most of this amount to the national banks.[58]

In July some interest was shown by certain European bankers,

[55] *Ibid.*, p. 53. The *Nation* ascribed the low state of the public credit not to the public generally, but to a certain type of political leadership. It pointed to "the rapidity with which a true appreciation of the condition of credit, and of the value of it, has been diffused through the community by mere discussion during the last three or four years." It perceived the fault to lie in the fact that "the organized mode of expressing the popular will on the great questions of the day is singularly imperfect, owing . . . to the rise into power and influence, through the events of the war, of a class of statesmen whose whole political experience and ability lie in the stimulation of emotion, and who are wanting in the habits of mind, as well as the kind of knowledge, which the business of a great nation absolutely requires" (*ibid.*, pp. 53-54).

[56] *Treasury Report*, 1870, p. vi.

[57] 16 Statutes 399.

[58] *Treasury Report*, 1871, p. xvii; Oberholtzer, *Jay Cooke*, II, 270-272; Boutwell, *op. cit.*, II, 187.

and in August arrangement was made with Jay Cooke & Company as the representative of bankers in Europe and the United States. Cooke formed two syndicates, one of them European and the other American.[59] It was agreed that the members of the syndicates would have

> the right to subscribe for the remainder of the [first] two hundred millions . . . at any time previous to the first of April [1872] . . . by subscribing for ten millions at once and for an average of at least five millions . . . per month . . . subject to the right of the national banks to subscribe for fifty millions of dollars within sixty days from the 25th day of August.[60]

The offering was immediately successful, and by September 1 the entire amount had been subscribed.[61]

By December, 1871, practically all the subscriptions had been taken up,[62] and the Rothschilds, who had thus far remained aloof, were now ready to join Cooke in further negotiations for the sale of the 5-per-cent issue. Their proposals were made to the Treasury early in 1872, and the bankers waited into the summer confidently expecting that their offer would be accepted.[63] By then it became apparent that considerations other than the financial welfare of the country weighed heavily with the Grant administration. The reason for the delay in continuing refunding at so opportune a time was purely political. ". . . it became clear that the administration feared the issue, and would let the Government pay six per cent. on its debt indefinitely rather than endanger Grant's chances for a second term."[64]

There had been some criticism of the manner in which the new bonds were sold and the old ones redeemed. Because called five-twenties required ninety days' notice before redemption, and the sale of the refunding bonds was the chief source of funds for their payment, Boutwell had allowed the subscribers ninety days' interest on the new bonds upon their depositing old bonds as a guaranty that the new ones would be taken. In this way subscriptions were more readily obtained, but the Secretary was criticized

[59] *Treasury Report,* 1871, p. xviii; Oberholtzer, *op. cit.,* II, 279.
[60] *Treasury Report,* 1871, p xviii.
[61] *Ibid.;* Boutwell, *op. cit.,* II, 187-188; Oberholtzer, *op. cit.,* II, 279.
[62] *Treasury Report,* 1871, p. xix.
[63] Oberholtzer, *op. cit.,* II, 288, 361.
[64] *Ibid.,* p. 361.

in some quarters for this arrangement. Apparently Grant and his supporters feared this criticism more than that which might arise from failure to continue the refunding. In August, 1872, he made it clear to the bankers that the operation must be postponed until after November.[65] Boutwell relates that in the autumn of 1872, when it seemed opportune to continue the sale of bonds in the same manner as before, he consulted with the President and Cabinet and "Upon their advice the negotiations were suspended."[66]

In January, 1873, Boutwell again made arrangements to continue the sale of the 5-per-cent bonds. Now, however, there was great rivalry among the important banking firms, and because the administration sought to please as many of them as possible, Cooke & Company participated but did not head the new syndicate. There was great optimism among the bankers, and it was decided that sale of the remaining $300 million 5 per cents would be undertaken. The market price of the bonds was pushed to a premium, and preparations were made for an extensive newspaper campaign. When the subscription books were opened in Europe and America early in February, a demand for $600 to $800 million of the bonds was generally expected.[67]

To everyone's surprise the negotiation was practically a failure. Sale of the bonds was small from the outset. Confusion as to calling the old bonds and lack of full co-operation on the part of the Treasury added to the difficulty. Finally, by the end of February some $50 million had been subscribed, and sales continued on a small scale for some time thereafter.[68] By December, 1873, subscriptions had been made to only $84.5 million. In addition to this, the $15.5 million received from England in September, in payment of the Geneva Award, had been invested in refunding bonds to be held "subject to the future disposition of Congress."[69] Thus, in the three and one-half years which had elapsed since passage of the Refunding Act, only $300 million of the $1,500 million refunding authorization had been sold.[70]

At a time which seemed propitious and when the hopes of even

[65] *Ibid.*
[66] Boutwell, *op. cit.*, II, 139.
[67] Oberholtzer, *op. cit.*, II, 366.
[68] *Ibid.*, pp. 372.
[69] *Treasury Report*, 1873, pp. ix-x.
[70] "The first steps towards the refunding of the debt have been taken very leisurely" (*Commercial and Financial Chronicle*, XIX, Aug. 8, 1874, 129).

the bankers ran high that all the remaining 5-per-cent bonds would be readily sold, the failure of the operation was certainly a harbinger of troubled times to come. The international investment market was already glutted with bonds and equities of every description. It was only the fervor which speculation and a false prosperity had engendered that concealed the true situation. In September the wild and desperate panic which seized the country extinguished any remaining hope that the remainder of the 5-per-cent issue could soon be sold. No effort was made to continue its negotiation until July of the following year.

After the violence of the panic had subsided and the long downward drift of the depression set in, the money market ruled easy. Early in March, 1874, the rate on call loans ranged between 3 and 5 per cent, and on commercial paper it was 5 to 6½ per cent.[71] During that month certain issues of the five-twenties sold around 120, and the 5-per-cent ten-forties around 115, on the stock exchange.[72] At about this time the 5-per-cent gold bonds of 1858, which were optionally due on January 1, were being readily exchanged for the new 5-per-cent bonds, many of these exchanges being for English accounts.[73]

That in spite of these developments conditions were not yet entirely favorable for extensive refunding is seen in the return of some $10 million of bonds from Europe late in March; and throughout the spring agitation for expansion of the greenbacks disturbed business, banking, and foreign trade.[74] The condition of the European markets was watched especially closely, for many of the bonds to be refunded were held abroad. Sale of the new bonds there had to be in considerable volume in order to prevent an adverse exchange balance when calls for the old bonds were made. Early in the summer of 1874 it was the opinion in financial circles that the European markets were "in a favorable state for the reception of our bonds."[75]

When Secretary Bristow assumed office in June, 1874, the unsold balance of the 5-per-cent loan was $178 million. In July he entered into a contract with a group of bankers representing financial

[71] *Ibid.*, XVIII (March 7, 1874), 242.
[72] *Ibid.*, XVIII (March 28, 1874), 311.
[73] *Ibid.*, XVIII (March 7, 1874), 242.
[74] *Ibid.*, XVIII (April 4, May 2, 1874), 337, 441.
[75] *Ibid.*, XIX (July 11, 1874), 25.

houses in both New York and London.[76] The same general arrangement was made with them that had been made in 1871 with the firm of Jay Cooke & Company, which in the meanwhile had gone down in the panic. After about $10 million in other subscriptions had been allowed, the syndicate was given the right to subscribe to the remaining 5 per cents on certain terms extending to January 31, 1875. The commission was one-fourth of one per cent, the syndicate to pay the cost of shipping the new bonds to London and the cost of transferring from London to the Treasury the called bonds, coupons, and gold used in payment for them.[77]

At first hope was high that the remainder of the 5-per-cent refunding bonds would be disposed of rapidly. By the first of August $25 million of them had been sold, but thereafter the sales fell off and came practically to a standstill in the late fall and winter. By the end of January, 1875, when the arrangement with the syndicate was to terminate, only about $55 million had been sold, $45 million of which was accounted for by the syndicate's operations.[78] This poor showing occasioned surprise and disappointment. Undoubtedly the depressed conditions of business and finance had much to do with this slow progress, but the syndicate was blamed. It was thought that the syndicate had simply acquired for itself a six months' monopoly of the refunding 5 per cents and with little effort had made a considerable profit, "while to ourselves there is nothing but disappointment at the insignificant amount of the funding operations which this new machinery has accomplished."[79]

On January 29, 1875, the contract with the syndicate was renewed[80] with slight modification of terms. The commission allowed was changed to one-half of one per cent, the syndicate to pay the expenses of preparing the new bonds as well as the transfer costs as agreed upon before.[81] Nearly $123 million of the 5-per-cent

[76] The contracting members of the new syndicate were August Belmont & Company, of New York, on behalf of N. W. Rothschild & Sons, of London, and their associates, and J. and W. Seligman & Company, of New York, for themselves and their associates. See *Treasury Report*, 1874, pp. ix-x, for details of the contract.

[77] *Ibid.*

[78] *Ibid.*, 1874, p. x; 1875, pp. xi-xii.

[79] *Commercial and Financial Chronicle*, XIX (Nov. 7, 1874), 465.

[80] Drexel, Morgan & Company, of New York, on behalf of J. S. Morgan & Company, of London, were included among the contracting parties in the new agreement (*Treasury Report*, 1875, p. xi).

[81] *Ibid.*

bonds remained to be sold. Conditions in 1875 were somewhat more favorable for refunding. Business activity had fallen to a low level, more money was available than the needs of business required, and funds tended to accumulate in the large financial centers.[82] The observation made during the panic that capital was waiting "to migrate in considerable amounts across the Atlantic"[83] began to prove true. The long depression had only halfway run its course, but idle liquid capital both at home and abroad gradually began to seek a safe and profitable investment in United States bonds. They sold more readily now, but still the rate of sale was not rapid. Although the Secretary announced in December, 1875, that "the funding of the five hundred million of six per cent bonds into those bearing five per cent interest has been accomplished,"[84] he referred to the fact that they had been subscribed by the syndicate. The actual distribution of the bonds continued until August, 1876.[85]

THE EUROPEAN MARKET

Three features of particular interest in the negotiation of refunding bonds on a large scale were the European market for United States bonds, the allowance of a commission to the firms which obtained subscriptions, and the disposition of the proceeds between the time of the sales and the time of redemption of the five-twenties to which the proceeds were required by law to be applied.

A large number of the five-twenties were held abroad. To provide funds in Europe for their redemption it was necessary to sell new bonds in European markets. In order to give added attraction to the refunding issues, Boutwell had recommended that the act authorizing them permit payment of interest in London, Paris, Berlin, and Frankfort, as the subscribers might desire.[86] As usual in Congress, there was hostility toward one aspect or another of Federal financing in European markets. At this time the opposition centered on the payment of interest in foreign financial centers. One sentiment was that this would involve a "sort of national degradation."[87] The principal objection, however, was that

[82] *Ibid.*, 1874, pp. xix-xxi.
[83] *Commercial and Financial Chronicle,* XVII (Nov. 1, 1873), 583.
[84] *Treasury Report,* 1875, pp. xi-xii.
[85] See Ford, *op. cit.,* III, 560-561.
[86] *Treasury Report,* 1869, p. xvii.
[87] Boutwell, *op. cit.,* II, 141.

such an arrangement would delay the rise of New York City as a world financial center.[88] Because Congress did not act upon this particular proposal, the Secretary, to achieve his purpose, simply directed that "interest on registered bonds could be made payable in checks of the Treasurer."[89] Another problem which Boutwell and his assistants encountered in European negotiation of refunding bonds involved the transfer of funds in the English money market, an operation of some delicacy which could influence the price of the bonds as well as their further sale.

COMMISSIONS

The question of a commission to be allowed the banks and investment houses which subscribed to the loan was not new in Treasury finance, but it was always an embarrassing one. The Refunding Act had appropriated one-half of one per cent from the proceeds of the bonds for the expense of preparing, issuing, advertising, and disposing of them. Thus the net commission might amount to about one-fourth of one per cent. When Francis E. Spinner, Treasurer of the United States, traveled through Europe early in 1871 to discuss the proposed loan with bankers and others who were financially informed, he gained the impression that

> An almost insuperable difficulty in the way of the negotiation of our loan was this low rate of commissions. . . . every banker and businessman with whom I conversed on the subject gave it as his opinion that one-quarter of one per cent. was altogether too small a compensation for the services to be rendered and the risks to be incurred.[90]

William A. Richardson, Assistant Secretary of the Treasury, had also gone to Europe to promote the negotiation of the bonds. His impression accorded with that of Spinner—that the rate of commission was too low. Boutwell was in agreement with them both. As at that time some consideration was being given to the possible sale of the 4 per cents and 4½ per cents following the completion of subscriptions to the first $200 million of 5 per cents, Boutwell expressed the opinion of both himself and Richardson that "the most serious obstacle in the way of negotiating the four and four-and-a-half per cent. bonds in Europe is the inadequacy

[88] *Congressional Globe*, 41st Cong., 2d Sess., Jan. 12, 1870, p. 379.
[89] Boutwell, *op. cit.*, II, 141.
[90] *Report of the Treasurer of the United States*, 1871, p. 256.

of the commission allowed." He believed strongly that a sufficiently large commission, even though it seemed "unnecessarily large," would "secure the negotiation of them with the least possible delay."[91] Apparently it was not then clear to the Treasury officials that in effect what their proposal amounted to was the sale of the 4's and 4½'s in a 5-per-cent market at what would represent a discount (in the form of a commission) sufficient to give the bonds a yield acceptable to the investment segment of the money market.

The question of commissions and the belief in the Treasury that the amount allowed hampered the sale of bonds persisted for some years. When Secretary Bristow was in office he went so far as to suggest an extreme alteration in the terms of the 4½'s (from redeemability in fifteen years to redeemability in thirty years) as a compensation for what he was convinced was a much too low commission rate.[92]

As in the days of Chase and Fessenden, the payment of commissions for the distribution of bonds was a sensitive point with Congress and the people. In the era in which refunding took place, suspicion of malfeasance in high office was widespread. Even the fractional net commission of one-fourth of one per cent represented a large sum of money on a substantial volume of sales, especially if the sales were readily achieved. Public opinion, none too kind to bankers at any time, also sensed that the bonds of the government should be highly desirable without much inducement other than the terms of interest and the maturities which the obligations actually bore.[93]

In some quarters there was resentment that the contract with the syndicate gave it a monopoly on the sale of the bonds. In August, 1871, the *Commercial and Financial Chronicle* pointed out, "The only method for the public to buy five per cents is to get them from the Syndicate."[94] It declared, "The public are . . . calling upon Mr. Boutwell to make a candid full statement of the details of the arrangement he has made with the syndicate."[95] There was a considerable amount of feeling that the syndicate had

[91] *Treasury Report,* 1871, pp. xix-xx.

[92] See above; and *Treasury Report,* 1875, pp. xi-xii.

[93] "Public opinion was decidedly adverse to . . . [the] proposition to allow more ample commissions and it was not listened to by Congress" (*Commercial and Financial Chronicle,* XIX, July 25, 1874, 74).

[94] XIII (Aug. 12, 1871), 197.

[95] XIII (Aug. 19, 1871), 229.

made a very good bargain with the Secretary and that directly and indirectly its profits from bonus, commissions, and riskless speculative activities amounted to perhaps 3 million on the bonds subscribed for that year. Dissatisfaction had been stirred up, and the management of the Treasury had fallen in public esteem.[96]

This unpopularity has its origin partly in the fact that more of secrecy has been thrown around the negotiation than has ever been permitted in the placing of any previous government loan. A more potent cause is the apprehension that private interest rather than the public good have been consulted in the whole arrangements.[97]

Secretaries Boutwell, Richardson, and Bristow had sold the bulk of the $500 million 5-per-cent refunding bonds through syndicates which received a commission of one-fourth to one-half of one per cent according to the various expenses which they assumed in connection with the preparation of the bonds, their shipment, and the transmittal of the proceeds of their sale.[98] The $200 million of 4½-per-cent bonds, the sale of which was negotiated by Morrill with the syndicate, was placed on the basis of one-half-of-one-per-cent commission.[99] The popular sale of $75 million of 4-per-cent bonds by the syndicate in 1877 was made on the same basis;[100] and in 1879, by an arrangement with the syndicate, $15 million of refunding 4-per-cent bonds was sold in Europe on the basis of one-fourth of one per cent plus one-tenth of one per cent on sales above $10 million, the Treasury to pay the cost of transmitting bonds and maintaining a representative in London.[101] The sale of $50 million of 4½-per-cent resumption bonds was made through the syndicate on the one-half-of-one-per-cent basis, the syndicate paying the cost of preparation and transmittal.[102]

[96] *Ibid.*, XIII (Dec. 23, 1871), 826.

[97] *Ibid.*

[98] *Treasury Reports*, 1874, p. x; and 1875, p. xi.

[99] A chronological account, supplementing the *Treasury Reports* in minute detail, of the negotiations, operations, surrounding circumstances, and the reactions of the individuals concerned in the refunding and resumption operations, principally while Sherman was in office, is rendered in the following collection of documents: U. S. Treasury Department Official Correspondence, Aug. 24, 1876, to Oct. 18, 1879, *Specie Resumption and Refunding of National Debt*, 46th Cong., 2d Sess., House Ex. Doc. No. 9. For the contract between Secretary Morrill and the syndicate, see pp. 2-4.

[100] *Ibid.*, pp. 61-62; *Treasury Report*, 1877, p. viii; and Sherman, *op. cit.*, I, 574.

[101] *Specie Resumption and Refunding of National Debt*, pp. 482-483; and *Treasury Report*, 1879, p. xv.

[102] *Specie Resumption and Refunding of National Debt*, pp. 295-296.

With the exception of the $90 million of refunding 4 per cents which Sherman disposed of through the syndicate, all the rest of this issue was offered directly through national-bank depositaries, the Treasury, and subtreasuries by means of public advertisement, or, as it was called, "under circulars." At first a commission of one-fourth of one per cent was allowed on all subscriptions of $1,000 or more.[103] With the new offering of the 4 per cents on January 1, 1879, a change was made in the commission rate to the extent that it was one-eighth of one per cent on subscriptions of $100,000 to $1 million, one-fourth of one per cent on those between $1 million and $10 million, and on amounts above $10 million an extra one-tenth of one per cent.[104] In this way Sherman sought to promote competition among the larger banks, but so much discontent resulted from the arrangement[105] that it was abandoned and the flat rate of one-eighth of one per cent for subscriptions of $1,000 or more was determined upon when the 4-per-cent refunding certificates were offered on March 12, 1879.[106]

CALLING THE OLD BONDS

Another feature of the refunding operations was the requirement that ninety days' notice be given in calling any of the outstanding five-twenties. The interest on these was to cease three months from the date of the notice. Although Cooke's syndicate, for example, quickly found subscribers for the $134 million it had undertaken to dispose of, it had required only a 5-per-cent deposit from the subscribers "as security for the validity of their subscriptions" until the bonds were delivered to them on December 1.[107] Thus, if the bond market were to decline more than five points during the three-month interval, many subscribers would probably refuse to meet their commitments. In fact, a decline of the ten-forties to about 96 during this period caused Cooke considerable alarm.[108]

The requirement of ninety days' notice for redemption of the five-twenties meant that for three months they would continue to bear interest, yet the Treasury upon giving the notice had to have, by reason of prudence, subscriptions in hand sufficient to meet the bonds when presented for payment. The manner in which this rather awkward condition was met proved to be a very definite

[103] *Ibid.*, p. 226.
[104] *Ibid.*, p. 446.
[105] *Ibid.*, pp. 469-470, 490-491.
[106] *Ibid.*, p. 562.
[107] Boutwell, *op. cit.*, II, 187-188.
[108] *Ibid.*, II, 188.

aid in encouraging subscription to the new bonds, especially on the part of the banks. The National Banking Act had authorized the secretary to use the banks as depositaries for public money other than the customs receipts; and the Refunding Act required that "money received for the new bonds should be used only in payment of bonds outstanding, known as five-twenty bonds."[109]

National banks making or obtaining subscriptions, and conforming with the usual procedure of depositing bonds with the Treasury as security, thus had "the use of the amount of their subscriptions for three months."[110] The Treasury had, of course, given assurance that "as the bonds called should mature, the deposits would be drawn from the several banks proportionately."[111] For the banks this meant three months of double interest on the amount of their subscriptions, a circumstance which undoubtedly did much to further the sale of the new bonds. Boutwell remarked of this, "the necessary loss to the Government incident to the refunding of the public debt was made the means of securing subscriptions to the amount of about one hundred and thirty millions of dollars."[112] Although the weight of this inducement cannot be measured, it is certain that it influenced the sale of many more bonds before the refunding program was completed.

SALE OF THE 4½-PER-CENT REFUNDING LOAN

With completion of the sale of the 5-per-cent issue in 1876, attention was turned to the sale of the 4½-per-cent bonds. A contract, similar in terms to the preceding one, was entered into with the syndicate on August 24.[113] The one-half-of-one-per-cent commission was again allowed, the syndicate to pay the costs of preparing and transporting the bonds, etc.,[114] as before. Secretary Morrill reserved the right to terminate the contract upon ten days' notice at any time after March 4, 1877.[115]

The improvement in the public credit and a favorable money market facilitated negotiation of the new bonds. The country was still in the grip of depression, but idle funds had accumulated as

[109] *Treasury Report*, 1871, p. xix.
[110] *Ibid.*
[111] *Ibid.*, p. xviii.
[112] *Ibid.*, p. xix.
[113] *Ibid.*, 1876, p. xi.
[114] Soon after Sherman took office in March, 1877, he appointed Charles F. Conant to represent the Treasury in London and manage all matters concerned with the refunding operations. "His compensation and allowances, as well as those of all persons sent to London in connection with the refunding of the public debt, were paid by the syndicate" (Sherman, *op. cit.*, I, 568-569).
[115] *Ibid.*, p. 568.

a result of the great liquidation and the ensuing slowdown of business activity. At the same time there was a lack of sound investments other than United States bonds. The attention of investors turned more and more toward them, and they sold quite rapidly. The latent power of the domestic capital market was indicated by the comparative ease with which the 4½-per-cent refunding bonds were marketed.

During the autumn of 1876 and the following winter, the great uncertainty associated with the presidential election, the result of which remained undecided for several months, cast a pall upon business activity and contributed to the popular unrest.[116] In addition to this influence upon the economy, the increasing success of the refunding program appears to have had unexpected repercussions upon business. The severe decline in prices which took place in late 1876 and early 1877 was ascribed, in part at least, to the rapid enhancement of the public credit which accompanied the sale of a large quantity of bonds. With this strengthening of the Treasury's position the prospect of resumption began to take on reality, and the premium on gold fell. As a consequence, prices in terms of greenbacks also declined, and this brought disaster to many businesses which until then had survived the ravages of the long depression.[117]

By May, 1877, the condition of the money market had become so favorable that "it became apparent to the Secretary that . . . four per cent. bonds could be sold at par, in coin, with great advantage to the Government."[118] Sherman was now in office. Although the contract with the syndicate did not expire until June 30, 1877, he took advantage of the clause which permitted him to terminate it. It was agreed that a total of $200 million of the 4½-per-cent bonds would be issued.[119] Of these, $185 million were applied to redemption of five-twenties, and the remaining $15 million were sold for coin under the authority of the Resumption Act for resumption purposes.[120]

[116] "The political uncertainty was unquestionably a great cause of depression during the fall of 1876 . . . . The progress of the electoral dispute during the winter rendered any recovery in prices impossible" (William M. Grosvenor, *American Securities: The Causes Influencing Investment and Speculation and the Fluctuations in Values from 1872 to 1885*, New York: Daily Commercial Bulletin, 1885, pp. 89-90).

[117] *Ibid.*, pp. 69, 87.

[118] *Treasury Report*, 1877, p. viii.

[119] *Specie Resumption and Refunding of National Debt*, pp. 14-16.

[120] *Treasury Report*, 1877, p. viii.

Sherman had further reasons for terminating the contract:

> Another reason for this step was that, in addition to refunding at a lower rate of interest, I wished to commence preparation for the resumption of specie payments on January 1, 1879, according to law. This could only be done by the sale of bonds for gold coin. I reserved the remainder of the four and a half bonds, amounting to $100,000,000, authorized by the refunding act, for resumption purposes in case the four per cent bonds could not be sold at par in coin.
>
> Another reason for the change in the existing contract was that it gave to the syndicate a monopoly in the sale of bonds while I wished to sell the bonds directly to the people.[121]

ATTEMPTS TO POPULARIZE THE DEBT

Soon after Sherman had assumed office in March, 1877, he undertook the gradual development of a policy which his predecessors had scarcely had the opportunity to consider and which, at the time they were engaged in refunding the debt, would probably have proved impractical. This was the popularization of the government's loans among its own people. One difficulty which had been in the way of this was the fact that, theretofore, the sale of bonds in Europe had been of first importance, for many of the bonds to be redeemed were held there. The alternative to such European sales would have been the export of gold, and this would have subjected the American money market to extreme pressure. The resulting stringency would undoubtedly have depressed the price of bonds and made it impossible to continue the refunding.

But when Sherman entered office the balance of trade was favorable to the United States and there was no longer the need to go deeper into debt with foreign countries. In fact, by 1878, it was estimated, only $200 million of United States bonds were held abroad, many having been returned and absorbed by the American market.[122]

One circumstance which made it difficult to sell bonds directly to the people was the provision that the bonds must be sold for coin. In his report for 1877 Sherman pointed out that

> As this was not in general circulation, it was impractical for the people to pay it into the Treasury for these bonds. Therefore, it became necessary to conduct all sales through third parties, who could receive

[121] Sherman, *op. cit.*, I, 571.
[122] *Treasury Report*, 1878, p. xviii.

bank-bills, United States notes, drafts, certificates, and other forms of commercial paper, and convert them into coin.[123]

In his report for 1878 he again referred to the retarding effect of the requirement that payment be made in coin, "the inconvenience of obtaining which, to the great body of the people outside of the large cities, deterred many sales. This will not affect sales after resumption when bonds can be paid for with United States notes."[124]

After terminating the contract with the syndicate for the sale of the 4½-per-cent bonds, Sherman promptly set about the negotiation of the 4-per-cent loan. On June 9, 1877, a contract was again arranged with the syndicate.[125] In accordance with Sherman's plan, a new provision in the agreement required the syndicate to offer at par to the "people of the United States" 4-per-cent bonds in denominations of $50 and $100 for a period of thirty days before general offering of the bonds in larger denominations was made. Subscribers were to have the option of making instalment payments for these small denominations over a three-month period. In the time allotted more than $75 million in popular subscriptions was made, the final payment date being October 16, 1877. Of the total sum realized, $50 million was applied to refunding and the remainder to resumption purposes.[126]

With the completion of this sale of bonds in October, the Secretary prepared to call more of the five-twenties, funds for their redemption to be obtained by disposing of additional 4's. At this juncture, however, several events combined to prevent, for a time, further financing. Agitation for the remonetization of silver and for the repeal of the Resumption Act, in combination with unfavorable political and economic conditions, so disturbed the investing public that the syndicate, believing further sales were not then possible, declined to offer more bonds at that time.[127]

From that time forward for many months there was scarcely any sale of government bonds at any price. The contracting parties [the syndicate] informed me that no bonds were then selling in the market and

[123] *Ibid.*, 1877, p. xi.
[124] *Ibid.*, 1878, pp. xvii-xviii.
[125] *Specie Resumption and Refunding of National Debt*, pp. 61-62.
[126] *Ibid.*; *Treasury Report*, 1877, pp. viii-ix.
[127] *Specie Resumption and Refunding of National Debt*, pp. 181-219; *Treasury Report*, 1877, p. ix; Sherman, *op. cit.*, I, 576-580; Noyes *op. cit.*, pp. 33-35; Ford, *op. cit.*, III, 561.

that in New York they were a trifle below par. Practically for the remainder of the year, government securities were greatly affected in price and value.[128]

Sherman was convinced that it was not in the public interest to continue the sale of refunding bonds through a banking syndicate. "I could see no reason why this function could not be performed by national banks, better than by bankers at home or abroad."[129] Following the sale of the popular loan in 1877, he dispensed with the services of the syndicate, and bonds were offered "to all alike by public advertisement."[130] In his annual report he outlined the possibility of a wide distribution of bonds in the American market and the advantages which might accrue from it:

> Prior to May, 1877, United States bonds were mainly sold through an association of bankers. Experience proves that under the present plan of selling to all subscribers on terms fixed by public advertisement, though the aggregate of sales may be less, their distribution is more satisfactory. Under a popular loan the interest is paid at home, and the investment is available at all times, without loss, to meet the needs of the holder. This policy has been carefully fostered by other nations, and should be especially so in ours, where every citizen equally participates in the government of his country. The holding of these bonds at home, in small sums well distributed, is of great importance in enlisting popular interest in our national credit, and in encouraging habits of thrift, and such holding in the country is far more stable and less likely to disturb the market than it would be in cities or by corporations, where the bonds can be promptly sold in quantities.[131]

A proposal, which foreshadowed the later establishment of the Postal Savings System, was made by Sherman with the view of distributing the debt so widely among the people that even the poor might invest their small savings:

> The best mode suggested is, that the Department be authorized to issue certificates of deposit of the United States of the denomination of ten dollars, bearing interest at the rate of 3.65 per cent. per annum and convertible at any time within one year after their issue into the four per cent. bonds authorized by the refunding act, and to be issued only in exchange for United States notes sent to the Treasury by mail or otherwise.[132]

[128] Sherman, *op. cit.*, I, 583. See also I, 599-602, and II, 603-607.
[129] *Ibid.*, I, 601.
[130] *Treasury Report*, 1878, p. xix.
[131] *Ibid.*, p. xviii.

In order to democratize the debt, the sale of some $40 million of refunding certificates in the denomination of $10 was undertaken. In authorizing this new type of obligation Congress had acted upon the suggestion of the Secretary.[133] On February 26, 1879, "An Act to Authorize the Issue of Certificates of Deposit in Aid of the Refunding of the Public Debt"[134] was passed. These certificates were to be "convertible at any time, with accrued interest, into the four per centum bonds described in the refunding act."[135]

The sale of the certificates when they were first offered in April was slow, but later in the month, when the 4-per-cent bonds into which they were convertible were offered at a premium, demand for the certificates increased rapidly. To discourage speculators who saw "a good thing," the Treasury limited each buyer to ten certificates at one purchase.[136] As a result there was considerable evasion, connivance, and complaint with regard to their sale.[137] Sherman wrote of them in his memoirs:

> They were sold in limited amounts to individuals at post offices, but as they were, when converted into bonds, worth a premium, bankers and others hired men to stand in line and purchase certificates. This was a practical fraud on the law, and was mainly conducted in the cities, and where done the sale was discontinued. The great body of the certificates were taken by the class of persons for whom they were designed. In a brief period they were sold, and the proceeds were in the treasury.[138]

Perhaps the greater part of these certificates was taken by "the class of persons for whom they were designed," but that humble class hastened to convert them for the small premium. Of the $40 million thus sold, more than $37 million were exchanged for bonds before the end of the year. In summing up the episode, James Gilfillan, then Treasurer of the United States, wrote, "The object of this loan was to furnish an investment for the small savings of the people . . . . the original purpose was almost wholly defeated."[139]

[132] *Ibid.*, p. xix.
[133] Sherman, *op. cit.*, II, 712.
[134] 20 Statutes 321.
[135] *Ibid.*
[136] *Treasury Report*, 1879, pp. xvi-xvii; *Report of the Treasurer of the United States*, 1879, p. 343.
[137] See *Resumption of Specie Payments and Refunding of National Debt*, pp. 714-718, 730-733.
[138] Sherman, *op. cit.*, II, 722-723.
[139] *Report of the Treasurer of the United States*, 1879, p. 343.

Following the cessation of bond sales in 1877 the market had remained unfavorable to further offerings for some months. By November 23, 1878, however, some improvement had come about, $100 million more of the 4-per-cent loan having been sold. Of this amount, nearly $95 million was for refunding purposes.

THE RAPID COMPLETION OF THE REFUNDING PROGRAM

The long depression came to an end. Through it all, the development of the country had continued; and the rate of development accelerated. The rapid growth of corporate enterprise at this time was closely associated with the development of a very powerful domestic capital market. National income and national wealth rose, and savings and liquid capital increased. A favorable balance of foreign trade and the flow of foreign investment funds into railway construction and industry further supported the great expansion of the economy which was taking place. The restoration of business confidence which accompanied the resumption of specie payments was a further strong stimulus to all forms of industrial and commercial undertaking. At the same time, the favorable effect of resumption upon the public credit quickly brought to completion the refunding operations.

The amount of refunding accomplished in 1879[140] was far greater than in any other year since the Refunding Act had been passed. The $40 million of refunding certificates, described above, was a small part of the total of obligations negotiated in that year. Until January 2, attention had centered on the preparations being made for the resumption of specie payments on that date. Sales of bonds for gold in this connection had slowed the progress of refunding. On January 2, the 4-per-cent refunding bonds were again offered for public subscription. "In view of the practical effect of resumption, the Secretary offered to receive United States notes in payment for the bonds sold."[141]

This simplification of what had before been, ordinarily, a three-party transaction involving the acquisition and payment of gold, was enough in itself to broaden the market for the bonds. Moreover, a combination of favorable circumstances had contributed to the improvement in the public credit, and the success of resump-

[140] For a minute account of the refunding activities in this year, see Sherman, *op. cit.*, II, 701-723; *Specie Resumption and Refunding of National Debt*, pp. 444-807.

[141] *Treasury Report*, 1879, p. xv.

tion, immediately apparent, enhanced it further. As a consequence, the 4's sold rapidly both within the United States and in Europe. The resulting calls for redemption of the five-twenties, many of which were still held abroad, made it necessary either to export gold to meet the cost of them or to place enough bonds in the London market to provide for their payment. The latter course was followed, a contract being made with certain banking firms for the foreign sales. By this arrangement $15 million worth were sold.[142]

When the 4's were offered in January 1879 with the commission graded according to the amount subscribed,[143] in the rush to buy bonds "the banks and bankers . . . were actively competing to swell these subscriptions, so as to get the larger commission offered for the greater amount of bonds sold."[144] Attractive to the banks, also, was the ninety-day call requirement whereby "The interest accruing for ninety days at six per cent. . . . was a loss to the government but a gain to the banks."[145] But when so large a volume of bonds was being disposed of, the requirement that ninety days' notice be given in calling in the five-twenties led to apprehension that "the deposit of the large amounts involved in refunding operations was to create a stringency in the money market."[146] The Secretary had suggested that this provision be modified so that notice of "not less than ten days nor more than three months" could be given, but Congress failed to act upon it.[147] Under the Act of January 25, 1879,[148] the Secretary did, however, receive authority to exchange 4's for uncalled five-twenties, but the amount so exchanged was only $806,000.[149]

On April 4, sufficient subscriptions were received to cover all of the five-twenties that remained outstanding. Nearly $61 million of additional subscriptions were rejected. On April 16, $150 million of the 4's were offered, this time at a premium of one-half of one per cent, the proceeds to be used in redeeming outstanding 5-per-cent ten-forties. The offering was oversubscribed the following day. "On April 21, a call was made for the remainder of the ten-forty bonds, and on the 23d, a call was made for $260,000, loan of 1858, thus completing the redemption of all outstanding redeem-

[142] *Ibid.*; Sherman, *op. cit.*, II, 705-707.
[143] Sherman, *op. cit.*, II, 703.
[144] *Ibid.*, 706.
[145] *Ibid.*, 708.
[146] *Ibid.*, 707.
[147] *Treasury Report*, 1879, p. xv.
[148] 20 Statutes 265.
[149] *Treasury Report*, 1879, p. xv.

able bonds bearing interest at five per cent."[150] "With this call the refunding operations were practically at an end for the time."[151]

In the short period of five months from November 23, 1878, to April 23, 1879, more than $370 million of 6-per-cent bonds and $193 million of 5-per-cent bonds were refunded into 4-per-cent bonds. The annual saving of interest from this brief operation was more than $9 million.[152]

By means of the refunding which took place between 1871 and 1879, nine different issues comprising $1,395 million of 6- and 5-per-cent bonds were consolidated into three issues bearing 5, 4½, and 4 per cent, at a total saving in annual interest charges of nearly $20 million.[153]

The following is a summary of the refunding transactions which took place between 1870 and 1879:[154]

Loans Refunded		
Title of Loan	*Rate (Per cent)*	*Amount Refunded*
Loan of 1858	5	$ 14,217,000
Ten-forties of 1864	5	193,890,250
Five-twenties of 1862	6	401,143,750
Five-twenties of March 1864	6	1,327,100
Five-twenties of June 1864	6	59,185,450
Five-twenties of 1865	6	160,144,500
Consols of 1865	6	211,337,050
Consols of 1867	6	316,423,800
Consols of 1868	6	37,677,050
Total		$1,395,345,950
Annual interest charge		$ 81,639,684.50
The Refunding Issues		
Funded loan of 1881	5	$ 500,000,000
Funded loan of 1891	4½	185,000,000
Funded loan of 1907 (including refunding certificates)	4	710,345,950
Total		$1,395,345,950
Annual interest charge		$ 61,738,838
Annual saving in interest charges on account of the refunding operations		$ 19,900,846.50

[150] *Ibid.*, p. xvi.
[151] Sherman, *op. cit.*, II, 723.
[152] *Treasury Report*, 1879, pp. xvii-xviii.
[153] *Ibid.*, pp. xviii-xix.
[154] *Ibid.*, p. xix.

CHAPTER VII

Debt Reduction and Tax Policy

Reduction of the immense debt was a major objective of fiscal policy after the Civil War. It was popularly approved, and there were comparatively few people who did not favor it—at least in principle. The furtherance of this policy depended, of course, upon a continuously high revenue. But tax reduction was also a highly desirable objective, and it too was made possible by large revenues. These two objectives thus conflicted, for neither could be furthered except at the expense of the other.

Surplus Treasury Receipts and the Real Extent of Debt Reduction

In each fiscal year between 1866 and 1879 there was a surplus of receipts over expenditures.[1] These surpluses were realized for

1866	$ 37,223,203	1873	$ 43,392,960
1867	133,091,335	1874	2,344,883
1868	28,297,798	1875	13,376,658
1869	48,078,469	1876	28,994,780
1870	101,601,916	1877	40,071,944
1871	91,146,757	1878	20,799,552
1872	96,588,905	1879	6,879,301

two reasons: (1) the relative conservatism displayed by the government in providing reductions in taxes, and (2) the unprecedented prosperity and growth of income which followed the war and which caused the revenue yield to be high. With the ending of the war there had begun a period of national expansion probably without precedent in the history of industry and commerce. As the West was opened up and the great railway systems were extended, foreign capital and labor flowed in to add their productive

[1] The surpluses of Treasury receipts for these years were as follows (*Treasury Report*, 1950, p. 451):

power to that of the domestic. The United States was rapidly rising to first place as a producer and exporter of agricultural products, and at the same time its influence in world finance increased greatly. An abundance of currency stimulated trade and supported a high level of prices.[2] Large Treasury receipts reflected the great increase in national income and wealth.

Between 1866 and 1877 the debt was reduced by $648 million. Of this large reduction, $604 million was accomplished between 1866 and 1873.[3] Smaller revenues after the panic of 1873 slowed the process of debt payment, and during the two years following 1877 borrowing for resumption purposes increased the debt. For the period of most rapid debt reduction, when between 1866 and 1873 the debt declined by $604 million, neither the amount of surplus revenue nor the debt-reduction total gives a true indication of the actual reduction that had taken place.

This is seen in the fact that many of the expenditures made by the government following the termination of the war were directly attributable to that catastrophe. They were "proper expenses of war," and in no sense "ordinary" expenditures, yet they were made from current receipts. Had it been necessary or possible to account for all the financial liabilities of the conflict at the time of its termination, the debt would have been considerably larger. This was shown by Boutwell, who, while a member of Congress, estimated that in this sense one-third of the debt had actually been paid by January 1, 1868—a period of two years and nine months from the end of the war.[4] Later in 1868 Secretary McCulloch also referred to the large amount of concealed debt reduction and stated that "the money expended by the War and Navy Departments, between the first day of April, 1865, and the first day of November, 1868, on claims justly chargeable to the expenses of the war, amounted to . . . $630,431,125.90."[5]

This fact, in conjunction with the simple figures of surplus Treasury receipts and of debt reduction, emphasizes the extraordinary rapidity with which the debt was being paid.[6] Under

[2] Noyes, *Forty Years*, pp. 1-5.

[3] *Treasury Report*, 1946, p. 455.

[4] *Congressional Globe*, 40th Cong., 2d Sess., July 21, 1868, p. 4297.

[5] *Treasury Report*, 1868, p. xx.

[6] McCulloch remarked of the phenomenal amount by which the debt was reduced: "That the reduction should have been commenced within seven months from the close of a war of unequalled cost, and continued through years of great financial depression, is about the last thing that the advocates or supporters of monarchy expected from a republican government" (*Men and Measures*, p. 209).

such circumstances policies of debt management and of taxation were necessarily closely related.

The Tax-Reduction Controversy

Although in the postwar period the people were willing generally to be taxed, and although Congress was prompt in reducing the internal levies, tax reduction nevertheless was a matter of controversy, not only with regard to the nature of the reductions but also with regard to the rapidity with which they should take place and the bearing of such reductions upon the problem of the debt. There developed, on the one hand, a conflict between the demands of special-interest groups and the requirements of financial statesmanship, and, on the other, the crystallization of antithetical views of conservatives and liberals. The direct burden of servicing and reducing the debt was the burden of taxation at its points of incidence.

Views regarding tax reduction varied among different business groups in accordance with the impact of prevailing taxes upon their particular interests. Bankers and manufacturers opposed the income tax and favored the high tariff rates, while merchants and importers opposed the protective tariff and tended to favor the income tax.[7]

The *Merchant's Magazine,* although it did not go so far as to recommend complete abolition of the income tax, came to regard it with disfavor.[8] When, in 1870, the *Commercial and Financial Chronicle* came out vehemently for further substantial reduction of taxes, it at first favored retention, in part at least, of the income tax to permit the repeal of "a multitude of other imposts which are much more mischievous."[9] Suggestion was made that the yield from it might

> . . . be applied to the remission of other duties, which are now a heavy burden upon those laboring men of the country, whose whole receipts in the year are not great enough to bring them within the reach of this, which is emphatically the rich man's tax.[10]

It urged a reduction of $50 million in customs duties and a

[7] Sidney Ratner, *American Taxation: Its History as a Social Force in Democracy* (New York: W. W. Norton & Co., Inc., 1942), p. 112.

[8] "One of the taxes most resented and objected to, because of its inquisitorial character, is the income-tax" LXI (Dec., 1869), 441.

[9] X (Feb. 19, 1870), 230.

[10] X (April 16, 1870), 487.

further reduction of $75 million in internal taxes, arguing that tax reduction would increase production and raise the revenues and that the "debt will be sooner paid."[11] In 1871, however, when the pressure of various monied interests was brought strongly to bear upon the administration to prevent any possible reconsideration of the tax before its expiration,[12] the *Commercial and Financial Chronicle* reversed itself by stating that general public opinion was opposed to the income tax and that removal of the tax "will remove one of the most serious sources of disaffectation towards the government among the people."[13]

Yet it could hardly be supposed that such a tax would be objected to by very many who were not subject to it. It was paid by a comparatively few people. Although the population was nearly 40 million, the number of persons assessed for the 1866 income tax was only 460,170; and for 1867 and 1868, after the exemption was increased, there were approximately 250,000 such taxpayers.[14] In 1865 the *Nation* had noted that there was no urgent demand for repeal of this tax.[15] Again, late in 1869, it observed no popular hostility toward it and perceived no reason why there should be. It commented, "We hear no complaint of it from anybody, except from the advocates of some other mode of raising the same amount of money."[16]

The same interests that decried the continuation of the income tax were opposed, also, to the prevailing Treasury policy which sought a rapid reduction of the debt. The *Merchant's Magazine*, interpreting public opinion in terms of the sentiments of its special class of readers, avowed, "The people will not submit to the pressure of heavier taxation than is needful to pay the interest of the debt and the expenses of an economical administration of the government."[17] This statement, made in November, 1869, appeared at a time when the many excise taxes of the war and postwar period had been substantially reduced or eliminated[18] and when a campaign against both the income tax and the inheritance tax was imminent in Congress.[19] So long as debt reduction was to con-

[11] XI (July 2, 1870), 5-6.
[12] Ratner, *op. cit.*, p. 134.
[13] XII (Jan. 7, 1871), 7.
[14] *Report of the Commissioner of Internal Revenue*, 1868, pp. 469-470.
[15] I (Sept. 7, 1865), 297-298.
[16] IX (Nov. 25, 1869), 452.
[17] LXI (Nov. 1869), 359.
[18] Taussig, *Tariff History*, pp. 162, 171-172.
[19] See Ratner, *op. cit.*, pp. 121-130.

tinue, a large revenue was necessary, and the income tax could yield a part of it. During 1869 Treasury purchases of bonds had brought about an appreciation in their prices on the open market. In August the *Merchant's Magazine* pointed out that national securities were worth "250 millions more than at the beginning of the year."[20] It took the peculiarly narrow view that this gain had gone to speculators, bankers, and their customers, and that none of it was available for lower taxes and the relief of the burdens of the people.[21]

The idea that money might better be left to "fructify in the pockets of the people"[22] than to be drawn from them by heavy taxation in order to reduce the debt rapidly had a considerable number of adherents, especially in financial circles and among the wealthy. The phrase had originated in England and was descriptive of Victorian debt policy,[23] for in England the national debt had come to be regarded as permanent.[24] The American tradition, however, being debt extinction,[25] those favoring permanent debt or slow repayment were in the minority. Their view was that with the growth and development of the country the burden of debt would be steadily reduced, that "every year lightens the pressure by distributing it over a wider area of population and wealth."[26]

[20] LXI (Aug. 1869), 144. [21] *Ibid.*, p, 146.

[22] *Commercial and Financial Chronicle,* XIII (Oct. 7, 1871), 454.

[23] Shirras, *Science of Public Finance,* I, 74.

[24] The English mercantile classes strongly opposed payment of the debt. It was "impossible for the government to maintain a surplus fund in the face of such a sentiment" (Adams, *Public Debts,* p. 260).

Hugh McCulloch, when visiting England, observed with surprise "the complacency with which the enormous debt of Great Britain was regarded by the generality of Englishmen." It was held that the national income had more than kept pace with the increase in the debt. "Very few, like Mr. Gladstone, seemed to regard it as an incumbrance upon the property of the nation, from which it ought to be relieved, even at the expense of increased taxation" (*Men and Measures,* pp. 471, 472).

Professor Alvin H. Hansen has suggested that "There are good grounds for believing that the post-Napoleonic debt exercised no depressing effect on the British economy and may, indeed, have played an important role in the economic progress of that country in the nineteenth century" (*Fiscal Policy and Business Cycles,* New York: W. W. Norton & Co., Inc., 1941, p. 156).

[25] As Francis A. Walker once stated, "It has been an Americanism to believe in paying off debts" ("The National Debt," *Lippincott's Monthly Magazine,* IV, Sept. 1869, 317). This national trait has been widely recognized. See, for example, Adams, *Public Debts,* pp. 240, 273; Seligman, *Studies in Public Finance,* pp. 205-207; *Treasury Report,* 1866, p. 8; Ford, in Lalor's *Cyclopaedia,* III, 562.

[26] *Commercial and Financial Chronicle,* XIII (Oct. 7, 1871), 454.

This same view was held by many, with regard to the resumption of specie payments, that the increasing wealth of the country would gradually bring it about. See, for example, Barrett, *The Greenbacks,* p. 172.

David A. Wells, a highly respected economist who served as Special Commissioner of the Revenue during McCulloch's term of office, favored a rapid reduction of taxes as a means of stimulating production, which he believed would in turn make possible a rapid reduction of the debt. He said:

. . . a rapid reduction of taxation, rather than a rapid reduction of the principal of the public debt, is at present the true policy of the government; and that the adoption of this course, so far from protracting the time at which the national debt can be discharged, will, on the contrary, greatly accelerate it.[27]

Some asserted that taxation yielding more than enough to pay the interest on the debt and provide for an economical administration of the government tended to impoverish the productive power of the country, that more harm than good was being done by rapid debt reduction, and that it was essentially uneconomical and wasteful.

Congress must repeal internal taxation rather than go on reducing, as heretofore, the national debt.[28]

We must adjust the National revenue closely to the expenses of the government, leaving a much smaller surplus to be devoted to the liquidation of the debt for some years to come.[29]

A later critic of the Grant administration and the policies of Secretary Boutwell has expressed very clearly this point of view regarding tax reform and debt reduction:

To some extent it [debt reduction] was not a bad policy. But when business was ready to pay 6 to 15 per cent for capital used in national development, when the government was able (as later refunding operations showed) to borrow at 4 or 5, it was assuredly unwise to use too large a share of the national income for debt-reduction. Moreover to centre every effort upon reduction, to sacrifice to it internal-tax reform, tariff reform, currency reform, and early refunding measures, was a meagre and sterile conception of financial policy.[30]

Following the panic of 1873 tax revision became an important objective of those political factions which spoke for the farmer,

[27] *Report of the Special Commissioner of Revenue*, Dec. 1866, p. 32.
[28] *Commercial and Financial Chronicle*, XIII (Oct. 7, 1871), 454.
[29] *Ibid.*, XIII (Dec. 9, 1871), 758.
[30] Nevins, *Hamilton Fish*, p. 288. Reprinted by permission of Dodd, Mead & Co.

laborer, and small businessman. For many years the re-enactment of an income tax was vigorously but vainly sought by the various third-party movements which represented labor and agriculture.[31] Between the years 1873 and 1879 there were introduced in Congress fourteen bills providing for an income tax. Yet the solution found by Congress in 1875 for the decline in customs revenue following the panic was to repeal the 10-per-cent tariff reduction of 1872.[32]

Gradual Reduction in Taxes

In 1866 the internal revenue system imposed a vast and chaotic burden. It included a moderately progressive income tax and an inheritance tax, a comprehensive system of excise taxes, and a general tax on manufactured goods at each stage of production. A license tax applied to almost every occupation, and the gross receipts of transportation, communications, and insurance companies were taxed. Before the war had ended Congress had been "willing to tax every possible article at the highest rate that anyone had the courage to suggest."[33] At its highest point, in 1866, the yield from internal revenue, including receipts from the income tax, was $309 million. It fell to $102 million in 1874 and increased only slightly thereafter.[34]

The wartime willingness of the people to submit to heavy taxation continued into the postwar years. Remembrance of the carnage and sacrifice of war, widespread journalistic comment on the enormous total of the debt and the need for its reduction, the generally prosperous condition of the country, and the innate good sense of a people who knew debt through personal experience, must have influenced this attitude strongly.[35] To the European financial observer, it was cause for amazement that such huge levies on many new sources of revenue could be so abruptly and so successfully imposed.

[31] Currency reform, of course, became the paramount issue, especially with the agrarian element, in these farm-labor alignments.

To the American workingman neither currency reform nor progressive taxation was of first importance. He was primarily interested in "higher wages and shorter hours." See Emanuel Stein and others, *Labor Problems in America* (New York: Farrar & Rinehart, Inc., 1940), pp. 153-154.

[32] Ratner, *op. cit.*, pp. 145-150.

[33] Taussig, *op. cit.*, p. 165.

[34] *Treasury Report*, 1950, p. 450.

[35] The magnitude of the debt was a clear and simple fact. Such matters, however, as its short-term nature, the requirements for its conversion, and the chaotic assortment and complexity of terms of the many bond and note issues could only bewilder and render more disturbing the conception of national indebtedness in the minds of a patriotic people. See Gibbons, *The Public Debt*, pp. 38-41.

In any other country the bare attempt would have caused a revolution. But in America these taxes are borne as patiently as taxes are ever borne in any country . . . . Congress simply laid a tax on everything it could think of, and let it hit whom it could. Yet this financial decimation of the people excites little murmuring.[36]

Late in 1868 Secretary McCulloch remarked, in a practical way, on this attitude of the people:

The people of the United States will never be so willing to be taxed for the purpose of reducing the debt as at the present time. Now, the necessity for its creation is better understood and appreciated than it can be at a future day.[37]

As late as 1870 the *Nation* noted with regard to the public attitude toward the debt, "The people have not shown, under the most tremendous pressure, the slightest sign of flinching."[38]

Reflecting this attitude of the people, Congress was able to reduce the taxes gradually. At the first session following the end of the war, a considerable reduction was achieved. Other reductions soon followed,[39] and in almost every year until 1872 internal taxes were further reduced or eliminated.[40] So steadfast was the purpose of Congress in this regard that actually a considerable part of the war taxes "were removed long before such action was expected by the people."[41]

By 1872 most of the internal taxes had been abolished. Except for the taxes on banks and on liquor and beer, the remaining taxes, such as those on patent medicines and on matches, were of little importance. In fact, "all those taxes which bore heavily on the productive resources of the country—those taxes in compensation for which higher duties had been imposed in 1862 and 1864—were entirely abolished."[42] Yet the import duties, which had been increased because of these internal levies, were not reduced.[43] In the post-Civil War years the tax system, except for the income and inheritance taxes, was regressive. The income tax, however, was

[36] The London *Economist*, XXIV (Dec. 22, 1866), 1481.
[37] *Treasury Report*, 1868, p. xxi.
[38] X (Jan. 27, 1870), 53-54.
[39] "Within the last two years we have surrendered internal taxes which might have yielded had they not been repealed $125,000,000. . . . This should be counted as some relief, and what more is possible must now be granted" (*Congressional Globe*, 40th Cong., 2d Sess., Dec. 11, 1867), p. 123.
[40] Taussig, *op. cit.*, pp. 171-172.
[41] Blaine, *Twenty Years of Congress*, II, 326-327.
[42] Taussig, *op. cit.*, p. 172.
[43] *Ibid.*

ended in 1872. The inheritance tax had been repealed two years before. Thus the entire burden of the Federal tax system fell on consumption.[44]

Secretary McCulloch, whose major debt policies were concerned with the conversion and reduction of the debt and the contraction of the currency in preparation for resumption of specie payments, needed large revenues to further his plans.[45] The rapid reduction in the debt by more than $206 million between August 31, 1865, and October 31, 1866, led him to believe, nevertheless, that Congress, which had already reduced the internal taxes, might consider further reduction both of the internal taxes and the tariff "in order that production may be increased and new life infused into certain branches of industry that are now languishing under the burdens which have been imposed upon them." He believed, however, that revenues should be maintained at a level sufficient to permit reduction of the principal of the debt by "four to five millions per month."[46] Congress, needing no persuasion to reduce taxes, acted with such dispatch that by 1868 the consequent diminution of the revenue caused McCulloch some concern.[47]

In his first annual report he had urged a revision of the tax structure to do away with the errors, abuse, and fraud which the prevailing complicated system encouraged.[48] By 1866 his proposals for improving the tax system and adapting it to the needs of the times became more specific. Perceiving the relationship between the debt and the burden of taxation, he urged

> That the burdens of taxes should fall chiefly upon those whose interests are protected by taxation, and upon those to whom the public debt is a source of wealth and profit, and lightly upon the laboring classes, to whom taxation and the debt are without so many compensatory advantages.[49]

To lighten these burdens he proposed that a careful revision of the

[44] Ratner, *op. cit.*, pp. 128-129, 134-135.

[45] See *Treasury Reports*, 1865-1868, *passim*.

[46] *Ibid.*, 1866, pp. 6-7, 24.

At this time President Johnson and his Secretary of the Treasury were in agreement on debt policy. In his second annual message the President said, "There seems now to be no good reason why taxes may not be reduced as the country advances in population and wealth, and yet the debt be extinguished within the next quarter of a century" (Richardson, *Messages and Papers of the Presidents*, VI, 451).

[47] *Treasury Report*, 1868, pp. xii-xv.

[48] *Ibid.*, 1865, p. 27.

[49] *Ibid.*, 1866, p. 22.

tariff be undertaken and that as soon as possible the debt be refunded at a lower rate of interest.[50]

Tax-reduction measures enacted by Congress in July, 1866, and March, 1867, were expected to reduce the annual revenue by approximately $105 million. Although, as a consequence, Treasury receipts declined substantially for the fiscal year 1867, they were still somewhat greater than anticipated.[51] Aware of the weight of taxation upon the people, McCulloch repeatedly urged economy in every branch of the government.[52] Much as he disliked a protective tariff,[53] he was reconciled to the thought that with "a heavy debt and liberal expenditures" even a tariff strictly for revenue must be a high tariff.[54]

McCulloch's debt-management policy as it was related to the question of taxation may be clarified by the following facts and the point of view which he expressed with regard to them: between November, 1867, and November, 1868, the debt had actually increased by $35,625,102.82;[55] during that time, however, the following unusual and nonrecurring expenditures had been made:[56]

Loans to the Pacific railroads	$24,152,000
Purchase of Alaska	7,200,000
Bounties to soldiers	44,060,515
Interest accrued prior to, but paid during, this period	4,000,000
Total	$79,412,515

Without these unusual expenditures, surplus receipts would have been more than $43 million. In view of this, McCulloch acknowledged that the "statement of the amount of the debt cannot be regarded an unsatisfactory one."[57] Yet merely on the presumption that tariff rates might be reduced, or that the early resumption of specie payments might cause a reduction in yield from the existing tariff, he strongly urged that internal taxes be increased.[58] This was at a time when such taxes were still a

[50] *Ibid.*, 1866, pp. 13-14.
[51] *Report of the Commissioner of Internal Revenue*, 1867, p. 256.
[52] *Treasury Report*, 1867, pp. xviii, xxi-xxii; 1868, pp. xii, xvii.
[53] McCulloch, *Men and Measures*, p. 509.
[54] *Treasury Report*, 1867, p. xviii; and 1868, p. xvi.
[55] *Ibid.*, p. xvii.
[56] *Ibid.*
[57] *Ibid.*
[58] *Ibid.*, pp. xiv-xv.

substantial burden,[59] and demands from certain sections of the public were continually being pressed for further reductions.[60] Tax-increase proposals are not lightly made by men in public office, yet such a proposal was being made by McCulloch at a time when the prospect for continuation of surplus revenues was excellent and the threat of possible deficit was remote. Along with this, he urged that the principal of the debt be reduced by $50 million each year.[61]

His conception that the debt might be a greater burden in the future than at the present was consistent with the conservatism reflected in his insistence upon a continuous contraction of the currency. How ingrained in the temperament of Secretary McCulloch was this conservatism, or perhaps pessimism, is revealed in the following statement:

> If it be understood that this debt is to be a perpetual encumbrance upon the property and industry of the nation, it is certainly to be feared that the collection of taxes necessary to pay the interest upon it may require the exercise of power by the central government, inconsistent with republicanism, and dangerous to the liberties of the people. The debt must be paid . . . . To insure its payment without a change in the essential character of the government, every year should witness a reduction of its amount and a diminution of its burdens.[62]

Although differing with McCulloch on the desirability of contraction of the currency, Secretary Boutwell, his successor, was in complete agreement with him regarding the need for rapid repayment of the debt. In fact, to some observers debt reduction was with Boutwell an obsession to which he sacrificed the attention appropriate to other aspects of the public finances. Again, like McCulloch, he was reluctant to lower taxes and felt that the revenue should always be sufficient to continue his program of debt reduction.[63]

In Congress Boutwell had represented the high-tariff interests of New England. He was frankly a protectionist, and his reiterated opinion that "the prosperous condition of the country is largely due to the revenue system inaugurated during the war, by

[59] The internal-revenue receipts, which were greatest in 1866, viz. $310,906,984, totaled $191,180,564 in 1868. *Merchant's Magazine,* XL (Feb., 1869), 103-105.

[60] *Ibid.,* LVIII (Feb., 1868), 113. [61] *Treasury Report,* 1868, p. xiii.

[62] *Ibid.,* p. xviii.

[63] *Ibid.,* 1869-1872, *passim;* Boutwell, *Reminiscences,* II, 137-138; Nevins, *op. cit.,* p. 288.

which manufactures and the mechanic arts have been extended and established," appears to have been a sincere conviction.[64] Contrary to some beliefs,[65] he was not hostile and "strongly opposed" to some amount of tariff reduction, although he felt that such reform should be undertaken with great care. He urged that tax reduction be subject to two considerations: first, that the country maintain its ability to reduce the debt by $50 million annually and, second, that "in the change of the revenue system no violence shall be done to the business interests of the country."[66] Although in May, 1872, the duties on tea and coffee were abolished and in June a general reduction of the major protective duties by 10 per cent was effected,[67] late that year Secretary Boutwell, in his report, anticipated further "general reduction in the percentage of customs duties."[68]

During Boutwell's term of office, revenues remained at a high level, there was a tendency for the currency balance in the Treasury to become unnecessarily large, and bond redemptions continued at a high rate.[69] The surplus revenues for the fiscal years 1870-1872, averaging nearly $100 million annually, were directly applied to the reduction of the debt.[70] Between May, 1869, and October, 1872, the total principal amount of bonds purchased exceeded $285 million at an average cost in gold of 94.64 per cent.[71] In his report for 1869 Boutwell had favored continuing taxes as they were in order to insure the success of the refunding operations then contemplated. In December, 1870, however, he cautiously proposed that, should conditions continue favorable, the next Congress might give consideration to "a very material reduction in the revenues."[72] By December, 1871, he had cast aside any remaining doubt. He stated, ". . . . the time has arrived when a considerable further reduction in taxes can be made."[73]

During 1871 and 1872, when pressure was renewed for the repeal of the income tax, Boutwell took a firm stand for its retention. It is said that at Cabinet meetings he sometimes sought to evade giving a clear statement of the government's financial condition lest

[64] *Treasury Report*, 1870, p. vi. See also *ibid.*, 1871, p. viii; 1872, p. xvii.
[65] Cf. Nevins, *op. cit.*, pp. 288-289.
[66] *Treasury Report*, 1871, p. viii.
[67] Taussig, *op. cit.*, pp. 179-190; Ratner, *op. cit.*, p. 133.
[68] *Treasury Report*, 1872, p. xvii.
[69] *Ibid.*, 1870, pp. vi, xv-xvi.
[70] *Ibid.*, 1870, p. iii; 1871, p. iii; 1872, p. v.
[71] *Ibid.*, 1872, p. 28.
[72] *Ibid.*, 1870, p. xvi.
[73] *Ibid.*, 1871, p. iii.

the information aid those opposed to the tax.[74] Political expediency rather than a sense of equity may have influenced him in this stand, although it was exactly the opposite of that taken by President Grant, who, in seeking the support of the wealthy for his 1872 campaign, opposed the income tax.[75] Far more probably his desire to continue the tax, at least until the date set for its expiration in 1872, was simply a part of his larger policy with regard to the public finances. It was entirely consistent with his careful and, for some years, reluctant approach to all matters of tax reduction; and it was entirely appropriate to his zeal in reducing the debt.

Boutwell's policy emphasizing debt reduction could have been formed through a process of elimination and a sagacious weighing of political expediency. He knew from McCulloch's experience the popular temper with regard to contraction of the currency. He knew too, that—in spite of the protestations of the financial press to the contrary, and in spite of the length of time that had elapsed since the war—there was still a considerable willingness on the part of the people to be taxed in order to effect debt reduction. He was convinced, furthermore, that debt reduction would enhance the public credit and that this development would in turn make possible the refunding of the debt on favorable terms and in time permit the resumption of specie payments.

Following Secretary Boutwell's election to the Senate he was succeeded by his friend and former assistant, William A. Richardson, whose policies with regard to the debt were much the same as his own. In 1873 the reduction of the debt continued, but at a reduced rate. Because of the tariff reductions made just before the beginning of that fiscal year, the revenues had fallen off while the expenses of the government had not diminished proportionately.

Following the panic in the fall of 1873, the revenues declined still further.[76] In spite of the severe depression into which the country was sinking, debt reduction continued. Treasury purchases of bonds for the sinking fund were a means by which the money market was afforded some relief.[77] Although great pressure was brought to bear upon the administration to anticipate the payment of the $20 million loan of 1858, which would become redeemable or payable[78] on January 1, 1874, the Secretary could not see

[74] Nevins, *op. cit.*, p. 590.
[75] Ratner, *op. cit.*, p. 132.
[76] *Treasury Report*, 1873, pp. viii-x.
[77] *Ibid.*, pp. xv-xvi.
[78] The registered bonds were "redeemable at the pleasure of the United States"

his way clear legally to do so. He believed that Congress must determine whether the issue was to be made payable on the first of the year.[79]

The amount by which the debt was reduced during the panic to relieve the stringency in the market was relatively small and incidental. Even during the depression, debt reduction was carried on primarily for its own sake. Richardson urged the need for great economy in the operations of the government and proposed the levying of additional taxes rather than "resort to borrowing money and increasing the public debt."[80] Francis E. Spinner, the Treasurer of the United States, although more realistic with regard to increasing the tax burden at such a time, expressed the long-standing Treasury attitude toward debt reduction when he wrote:

> The falling off of the receipts, and the increase of expenditures, have put a check upon the rate per annum at which the public debt was paid off in preceding years . . . . Either taxation must be increased, an expedient that can hardly be thought of, or the appropriations must be kept largely below the receipts. Otherwise the rapid reduction of the public debt will be arrested, if not abandoned.[81]

Secretary Bristow was in office during the depression years 1874 and 1875. At that time receipts narrowly exceeded expenditures. In 1874 it was possible to reduce the debt by $5 million,[82] and in 1875 by $14 million.[83] Bristow urged the greatest possible economy in government expenditures in order to sustain the public credit and permit refunding of the debt at lower rates of interest, pointing out that there would be a "greater willingness on the part of the people to bear the burden of taxation, when they see that their government, like themselves, is reducing expenditures."[84] During 1874 expenditures, other than for the public debt, decreased by approximately $2 million.[85]

In the fiscal year 1876 the debt was reduced by $29 million.[86] Taxation, however, had receded as an important issue. Secretary

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after Jan. 1, 1874; the coupon bonds—the greater part of the issue—were "payable at any time after the 1st day of January, 1874." This confusion of terms was apparently the result of someone's carelessness (*ibid.*, pp. x-xi).

[79] *Ibid.*, pp. x-xi.
[80] *Ibid.*, pp. viii-ix.
[81] *Report of the Treasurer of the United States*, 1873, pp. 293-294.
[82] *Treasury Report*, 1874, p. viii.
[83] *Ibid.*, 1875, p. vii.
[84] *Ibid.*, p. ix. See also 1874, pp. xvii-xviii.
[85] *Report of the Treasurer of the United States*, 1874, p. 349.
[86] *Treasury Report*, 1876, p. iv.

Morrill, then in office, centered his attention upon continuation of debt refunding and the prospective resumption of specie payments. At this time the farm-labor forces in politics neglected the subject of taxation to concentrate their efforts upon currency reform and denunciation of the Resumption Acts.[87]

As with his predecessor, the major objectives of Secretary Sherman, until 1879, were to continue the refunding of the debt and prepare for the day of specie resumption. At this time little consideration was given to matters of taxation. In each year of Sherman's administration fairly substantial repayments of debt were made, although before 1880 the amounts did not fulfil the annual requirements of the sinking fund.[88]

Tax reform made no progress between 1872 and 1879, although those years saw the establishment of new political parties representing labor and agriculture. A determined bloc of Midwestern and Southern congressmen fought for, but failed to achieve, the restoration of the income tax. Instead, Congress increased the tariff by 10 per cent. During the long depression, debt reduction continued while the regressive burden of taxation was increased.

The Tariff and the Debt

The high tariff enacted during the war and retained thereafter at the express demand of the manufacturing interests contributed greatly to the continuous excess of government revenue and hence facilitated the rapid reduction of the debt. The relation of the tariff to the debt was such that while high duties permitted debt reduction, the existence of the debt was itself an excuse for maintaining the high tariff.

It cannot be said with certainty that had there been no debt the tariff burden would have been lightened or eliminated. But the existence of a large debt gave a strong argument to high protectionists and induced many of more liberal persuasion to acquiesce in the high rates. The maintenance of high duties depended upon the debt—through its reduction—as a means by which surplus revenues could be disbursed. This was a time when other outlets for government funds were few, for it was not yet in the mores for the government to spend largely on tangible and intangible national

[87] Ratner, *op. cit.*, p. 147.

[88] According to Treasury accounting at that time, the debt was reduced each year as follows: 1877, $24.5 million; 1878, $17.1 million; and 1879, $0.8 million (*Treasury Report*, 1877, pp. iii-iv; 1878, pp. iii-iv; 1879, p iv).

improvements and otherwise collect and pay out funds for the general welfare.

At the end of the war it was generally assumed that within a reasonable time the tariff rates, which averaged 47 per cent on all dutiable commodities,[89] would be lowered.[90] By 1870 the belief—perhaps wishful—was current among British businessmen and financiers that "the opinion in favour of lower duties is now the strongest in America . . . the set of the current is all against the tariff."[91] Such was the strength of the protectionist bloc in Congress, however, that the tariff act of 1864, with all its flagrancies, was continued almost without change until the general revision of rates in 1883.[92] Long before this revision was undertaken the attitude toward the prevailing rates was that they were "the normal results of an established policy. . . . They had ceased to be thought of as the results of war legislation."[93]

Hugh McCulloch, who regarded the tariff as "the most insidious, and in some respects the most unequal of all taxes,"[94] had foreseen this perpetuation of the high import duties when he wrote:

> The general tariff policy is, I apprehend, settled by the national debt . . . . The necessities of the government will give to our manufacturing interests all the protection they will require to shield them from destructive foreign competition.[95]

More than twenty years later he was to observe in his memoirs:

> This much must be said in praise of the United States Tariff Act of 1862, that by the high duties which it imposed, and the taxes on whiskey and tobacco, etc., etc., more than one-half of the United States debt has been paid. . . .[96]
>
> . . . . . .
>
> The country is . . . indebted to the protective tariff for the rapid reduction of the public debt . . . .[97]

[89] Taussig, *op. cit.*, p. 167.

[90] "Had the question been directly put to almost any public man, whether the tariff system of the war was to be continued, the answer would certainly have been in the negative" (*ibid.*, p. 173).

[91] *Economist*, XXVIII (May 28, 1870), 662.

[92] Taussig, *op. cit.*, pp. 168-170, 173.

[93] *Ibid.*, pp. 169-170.

[94] McCulloch, *op. cit.*, p. 509.

[95] Letter of April 4, 1865, to Henry C. Carey, reprinted in the *Bankers' Magazine*, XIX (May 1865), 918.

[96] McCulloch, *op. cit.*, p. 473.

[97] *Ibid.*, p. 296. He might have added, of course, that the heavy expenditures for interest payments and debt retirement enabled the Treasury to make use of large tariff revenues which otherwise, under the Independent Treasury System, would have become a burden and an embarrassment.

After the postwar tax reduction, nearly all of the government's revenue was derived from import duties and from certain internal taxes on consumption goods. It was a highly regressive tax system in which the final incidence of the levies was upon the consumer regardless of his ability to pay.[98] It was an uneconomic tax system as well, for in so far as the tariff protected manufacturers and made possible higher prices it also caused a transfer of a part of the consumers' income to manufacturers either as a profit or as a subsidy for an unnecessary industry or an otherwise submarginal unit in an industry. As a subsidy, more often than not it was simply waste and loss in the same way that any other inefficiency or misplacement of capital is loss. The tendency of the higher prices to reduce demand must, in some cases, have resulted in higher unit cost of production, the fullest use of productive resources thereby being prevented.

The tariff was thus a far more expensive tax than its revenue yield indicated. Although it enforced saving on a great part of the population, most of the benefit of the saving did not accrue to those whose sacrifice it represented. Even from the purely economic point of view this was expensive saving, for the dollar values of which consumers were deprived greatly exceeded the amount of new capital created in the process. The subjective cost of this enforced saving for those consumers at or near the margin of subsistence was enormous.[99]

With so completely regressive a tax system the burden of servicing and reducing the debt fell directly upon the agricultural, laboring, and merchant classes. Unhampered by taxation, wealth accumulated the more rapidly for those in control of industry and finance. To the extent that the tax burden was thus unequally

[98] "It is impossible that any person in the country can be free from the burden of our national debt. Whoever eats food or wears clothing pays a share of the common tax, which therefore falls on man, woman, and child" (Gibbons, *op. cit.*, p. 43).

[99] In 1869 David A. Wells estimated that the net annual saving or addition to the productive capital of the nation was not more than $600 million (*Report of the Special Commissioner of the Revenue*, 1869, p. lii).

Of this he said: "But when we consider how small, even under the most favorable circumstances, is the net saving which annually accrues to any nation as compared with the value of its annual gross product . . . we can readily understand how difficult it must be, of necessity, for a producer, starting without capital, to make his first accumulation, and how a slight change in the distribution of the net annual profit of the nation may make to the masses all the difference that exists between abundance and deficiency, advancement and retrogression" (*ibid.*, p. liv).

shared, the ownership of the growing capital of the country gravitated toward those whom the tax system favored. It may be said that the debt helped to retain an uneconomic and outmoded institution, namely, a vicious system of taxation fostered for the benefit of a few at the expense of the many and concealed to a large extent by the existence of the debt and the necessities of its management.

The Significance of Debt Reduction

Debt reduction is the central problem of debt management. The means, the manner, and the rate of reduction—and whether a public debt should be reduced at all—have always been matters of controversy. Opinions regarding it range from one extreme which favors a continually increasing debt to the other which urges that the debt be rapidly reduced and extinguished.

In the latter part of the nineteenth century the usual arguments in defense of perpetual debt were: (1) that the burden of it continually decreased with the gradual depreciation of the monetary unit which resulted from an increase in the stock of specie and improvements in the mechanisms of exchange; and (2) that the debt was, in effect, reduced by the expansion of the economy and the increasing wealth of the nation.[100] Underlying these arguments was the belief that the payment of public debt destroyed capital and hampered the development of the country.

That such a belief is fallacious is seen in the fact that the payment of an internally held national debt is simply a transfer of capital or current savings from certain individuals to others and is in no way a destruction of capital. In fact, so far as debt reduction, through taxation, induces savings, new capital is created. Following the waste and destruction of the Civil War, and at a time of enormous national expansion, saving and the creation of new capital was especially desirable.

To the extent that the original war borrowing had drawn upon capital and the tax levied to pay it had come from current income, capital was thereby restored to productive uses, for the bondholders who were repaid may reasonably be supposed to have reinvested their funds. If the whole amount of postwar debt reduction had been due to a tax on capital, as in the case of a capital levy, or if the debt paid had been a foreign loan, the capital of the country would not have been increased by the process.[101] Yet in either event the in-

[100] Adams, *Public Debts*, pp. 241-246. [101] Bastable, *Public Finance*, p. 698.

terest cost of the debt would have been reduced. In such instances the argument that money should be left "to fructify in the pockets of the people" might have had justification, depending upon the rate of interest paid on the public debt compared with that prevailing in the loan markets.

If the debt had been relatively small, the economic effects of repayment would have been unimportant, especially if the taxes by which the funds were procured had been "just and equitable." But in the redemption of a large amount of debt in the post-Civil War period the means of obtaining the requisite revenue was highly regressive. It placed most of the burden of debt reduction upon those least able to bear it. Had the bulk of the revenue been obtained through a highly progressive tax on income, the greater the rapidity with which debt reduction took place the less would have been the burden upon the poorer classes of people. Yet, if the incidence of heavy taxation had been such that it reduced the profits of enterprise below a normal level and inhibited business incentive, the advantageous influence of debt reduction upon capital formation would have been negated.

In general, it may be said that the size of the debt in proportion to the national wealth and income, and the nature and extent of the taxes levied in order to reduce the debt, determine the effect of debt reduction on the national economy. Excessive taxation for interest and amortization will tend to slow industry, discourage enterprise, and reduce the national product, thereby increasing the burden of the remainder of the debt. Up to a certain point, however, taxation for debt payment tends to stimulate savings. Thus, the amount levied should not be so large that this effect is lost and the tendency to save is diminished. It is especially important, following the waste and destruction of a great war, that the reduction of national debt be so managed that it promote rather than reduce saving.

In a postwar period there are especially strong arguments for the reduction of government debt. At such a time the price level is high, yet it may be anticipated that in the course of time prices will decline. Following a war, industry has become adjusted to high taxes, and conditions generally are prosperous. Under such circumstances repayment is made easier and less costly for the government. Dollars of depreciated purchasing power swell the

revenue, and a surplus is ordinarily available for debt redemption. Since the economy has adapted to heavy taxation, and because conditions are prosperous, the need for rapid tax reduction is not urgent. Prudent debt management should consider taking full advantage of such a situation before changing circumstances remove the opportunity.[102]

The consensus of serious students of finance that public debt should be reduced even at the expense of relatively heavy taxation appears to have continued until the depression era of the 1930's. In the elaborate and exhaustive study of the British national debt made by the Colwyn Committee, whose report was rendered in 1927, it was stated that "not one of our witnesses has suggested that it is unnecessary to make any provision for debt redemption."[103] Similar to the reduction of internal taxes following the Civil War was the reduction of taxes after World War I. At both times it appears that the pressure brought to bear for tax reduction rather than debt payment was to a considerable extent *within* Congress, and for political reasons.[104]

Classical and neoclassical economists, with the notable exception of Malthus, regarded public debt as burdensome and harmful. Some others, however, far in the past as well as in the nineteenth century, saw no harm in a national debt, or even favored increasing it as a means of economic expansion. The more notable older writers who held these views were Bodin, Petty, Melon, Stewart, and Pinto. In Germany in the latter part of the nineteenth century Dietzel, Von Stein, Michaelis, and to some extent Adolf Wagner stressed the favorable aspects of government borrowing.[105] Never-

[102] For discussions of various aspects of debt reduction, see the following: Dalton, *Principles of Public Finance,* p. 269; Harley L. Lutz, *Public Finance* (4th ed.; New York: D. Appleton-Century Co., Inc., 1947), pp. 554-556; A. C. Pigou, *A Study in Public Finance* (London: Macmillan & Co., Ltd., 1928), pp. 290-295; Simeon E. Leland, "Debt Retirement and the Budget," *American Economic Review,* XXVII (March 1937), supplement, p. 81; Seligman, *Currency Inflation,* p. 61; Josiah Stamp, *Wealth and Taxable Capacity* (London: P. S. King & Son, Ltd., 1922), p. 179; Matsushita, *Economic Effects,* p. 163; Shirras, *op. cit.,* II, 805-806; Withers, *Retirement of National Debts,* pp. 304-307.

[103] Great Britain, Treasury, *Report of the Committee on National Debt and Taxation* [with Minutes of Evidence and Appendices], 4 vols. (London: His Majesty's Stationery Office, 1927), p. 329. See also p. 392.

[104] For a discussion of the controversy over this question in Congress following World War I, see Henry George Hendricks, *The Federal Debt, 1919-1930: A Chapter in American Public Finance* (Washington: Mimeoform Press, 1933), pp. 192-199.

[105] Seymour E. Harris, *The National Debt and the New Economics* (New York: McGraw-Hill Book Company, Inc., 1947), pp. 51-71.

theless, there is no real counterpart in the past for the present school of thought which maintains that public debt may be increased almost without limit and which views the debt primarily as an instrument of economic control.

The large debt reduction which took place within eight years after the Civil War, and the very large proportion of it which was achieved in the first three of those years, was accomplished without harm to business. In spite of demands in certain quarters for more rapid tax reduction at the expense of debt reduction, repayment of a large amount of debt appears to have had a highly favorable psychological influence upon business initiative. Even with all the repayment that had been made, however, at the end of the period with which this study is concerned, the debt was still of considerable size. The part it played in providing an outlet for surplus customs duties was to continue, and the high tariff along with it.

Although at this point emphasis has been placed upon the taxation aspects of debt management, it is to be remembered that currency problems were even more intricately enmeshed with it. The questions of currency contraction and expansion and the long-anticipated resumption of specie payments bore heavily upon the debt-management policies of each administration. A clear conception of the significance of the debt and its management recognizes the fact that problems of the debt, taxation, and the money supply are all closely interrelated and that the monetary aspects of the debt are of the highest importance.

CHAPTER VIII

The Sinking Fund as a Mechanism for Debt Reduction

Typical of the illusion and confusion which characterized much of the financial thought in this period was the notion of the compound-interest sinking fund. Its conception and enactment into law were as much a reversion to the weakest aspects of eighteenth-century European finance as were the creation of printing-press money and the proposal of various schemes for repudiating the debt.

As a part of the debt contract, the sinking fund is a promise added to the other promises expressed or implied in the obligations themselves and in the legislation relating to them.[1] It may take many forms, the simplest of which is an annual appropriation made when practicable for the redemption of a part of the debt. A more complex arrangement is the separately managed fund to which required annual appropriations are made for the purchase of obligations to be held in the fund, the interest upon them to be used for additional purchases in subsequent years. To this latter form of sinking fund almost magical properties have sometimes been ascribed through the operations of compound interest. This kind of fund was made mandatory under the provisions of the Loan Act of February 25, 1862.[2]

The Influence of British Sinking-Fund Theory

Great Britain had experimented with sinking funds early in her debt career, twice within a century discovering that they had no

[1] Underlying the sinking-fund idea is recognition of the human limitations set upon the acts of governments, especially with regard to debt payment. "Government, being administered by men, is naturally, like individuals, subject to particular impulses, passions, prejudices, vices; of course to inconstancy of views and mutability of conduct" (Alexander Hamilton, "Second Report on the Public Credit," *Papers on Public Credit, Commerce and Finance*, ed. Samuel McKee, Jr., New York: Columbia University Press, 1934, pp. 145-146).

[2] 12 Statutes 345.

magical attributes by which, automatically and painlessly, the debt was eliminated. Such a fund was established in 1716, but after some years the amount acquired by it but little exceeded the additional debt contracted by the government. By 1733 the plan for keeping the sinking fund inviolate was abandoned. The scheme was revived when Sir William Pitt consolidated the great mass of British debt in 1786.[3] He put into effect a sinking-fund system proposed by one Richard Price, a dissenting clergyman, who was distinguished not only as a moral philosopher but as a pioneer in actuarial science.[4] Price had demonstrated that a relatively small annual payment allowed to accumulate at compound interest would expunge a huge debt in a few generations.[5]

The fallacy of this arrangement was, of course, that in times of deficient revenue the government was in a position of buying in its obligations while at the same time attempting to sell yet a greater amount to raise needed funds.[6] Under such conditions sinking-fund operations merely added to the burden of the debt.[7] Contemporary students of finance recognized the illusory nature of the device;[8] and eventually Pitt's sinking fund was abandoned and replaced by a more realistic one.[9]

[3] Robert Hamilton, *An Inquiry Concerning the Rise and Progress, the Redemption and Present State, and the Management of the National Debt of Great Britain* (Edinburgh: Oliphant, Waugh, and Innes, 1813), pp. 93-101.

[4] Carl B. Cone, "Richard Price and the Constitution of the United States," *American Historical Review,* LIII (July 1948), 726-728.

[5] Robert Hamilton, *op. cit.,* pp. 131-132.

[6] In only one year between 1793 and 1829 was it unnecessary to borrow to support the sinking fund (Shirras, *Science of Public Finance,* II, 890).

[7] Robert Hamilton, *op. cit.,* p. 152.

[8] *Ibid., passim.* Ricardo believed that Pitt's sinking fund encouraged expenditure and, therefore, "instead of diminishing the debt, greatly increased it" ("Essay on the Funding System," *The Works of David Ricardo,* ed. J. R. McCulloch, London: John Murray, 1846, p. 545). In his correspondence Ricardo wrote, "There is no real fund nor can there be while we are in debt" (R. O. Roberts, "Ricardo's Theory of Public Debts," *Economica* (new series), IX, Aug., 1942, 263). Lord William Grenville pointed out that there must be a surplus from revenues, not loans, to reduce debt; that in time of war a sinking fund is highly "inefficient"; and he concluded, "The great source of all error on this subject, if error it be, has been the spirit and love of system" (*Essay on the Supposed Advantages of a Sinking Fund,* London: John Murray, 1828, pp. 12-13, 82). An elaborate analysis of British sinking-fund experience and the false principles of Price's theory is made in J. R. McCulloch, *A Treatise on the Principles and Practical Influence of Taxation and the Funding System* (London: Longman, Brown, Green, and Longmans, 1845), pp. 449-466 *et passim.*

Perhaps the most concise criticism of Price's compound-interest sinking-fund theory was made in later times by Henry C. Adams: "So long as one holds in mind the total of the debt and the total of the amount assigned each year to the service of the debt he will not be misled by sinking-fund calculations. The theory

Alexander Hamilton, in funding the Revolutionary War debt, was influenced by contemporary British sinking-fund theory. He made "the redemption fund of 1790 a real sinking fund after the English model";[10] and "the sinking fund of 1795 was the most rigid that could be devised. The law sought to fix the policy with regard to the debt for many years to come."[11] Hamilton was following in the footsteps of Pitt. In proposing this strict form of sinking fund it was his intention to extinguish "the whole of the present debt . . . in a period not exceeding thirty years," and for that reason the fund should be so constituted as "To fix its destination unchangeably, by not only appropriating it permanently, under the direction of commissioners, and vesting it in them as property in trust, but by making its faithful application *a part of the contract with the creditors.*"[12]

In 1803, however, under Secretary Gallatin,[13] the sinking fund was reorganized, given broader scope, and new sources of revenue were added to it. Gallatin did not attempt to do away with sinking-fund legislation, for it was regarded as a check upon the Secretary of the Treasury. Abhorring the "mystifying and useless machinery" of the formal, compound-interest sinking fund, he sought simple and direct ways to deal with the problem of debt reduction.

> There is disclosed in the administration of Mr. Gallatin the true policy of debt-payment. It consists in the establishment of a permanent appropriation for the service of the debt which shall be in excess of the demands of current interest. But such appropriation need not be 'inviolable.' It need form no part of a 'private contract,' nor be regarded

assumes the sinking-fund to be productive, whereas it is not productive. It is not a productive process to pass money from one account to another when both accounts belong to the same person" (*The Science of Finance,* 1898, p. 562). Another later writer pointed out that "The South Sea Bubble and Law's Mississippi scheme each had likewise in view . . . the extinguishment of public debt by financial legerdemain" George Morgan Browne, *The Sinking Fund* (2d ed.; Boston: Roberts Brothers, 1880, p. 4).

[9] Francis W. Hirst, *The Credit of Nations,* National Monetary Commission Publication (S. Doc. No. 579, 61st Cong., 2d Sess., 1910), p. 21.

[10] Edward A. Ross, "Sinking Funds," *Publications of the American Economic Association,* 1st series, 1892, Vol. VII, Nos. 4-5, p. 351.

Price was esteemed by many prominent Americans both for his sympathy to their cause in the Revolution and for his writings. Hamilton is known to have used Price's actuarial tables in settling claims for soldiers. See Cone, *op. cit.,* pp. 728-729.

[11] Ross, *op. cit.,* p. 360.

[12] Alexander Hamilton, *op. cit.,* p. 154.

[13] "Under the guidance of his clear insight this country departed from the pernicious methods of English financiering" (Adams, *Public Debts,* p. 268).

as constituting 'private property.' A government should always be at liberty in time of an emergency to divert money held for the payment of a debt to the support of new loans.[14]

By 1817 the growing disillusionment with the complex scheme in England was paralleled by the institution of a simple system of debt redemption in the United States. The sinking fund established in that year merely provided $10 million annually for that purpose, the obligations acquired to be canceled and no accruals of interest on them to be considered. "In the redemption plan of 1817 the sinking fund reaches almost the extreme of simplicity .... Simplicity and common sense had triumphed."[15] In financing the Civil War, however, the government reverted to the more complex sinking-fund arrangement.

Desuetude of the Civil War Sinking-Fund Law

Following the suggestion made by Secretary Chase, Congress had provided in the Loan Act of February 25, 1862, for the establishment of a sinking fund. Coin received in payment of import duties was to be applied first to interest on the debt and then "To the purchase or payment of one per centum of the entire debt of the United States, to be made within each fiscal year . . . which is to be set apart as a sinking fund, and the interest of which shall in like manner be applied."[16]

It was a clear provision for payment of both present and future debt, and as such it was a part of the contract between the government and those from whom it borrowed.[17] Underlying the provision appears the same illusion on the part of the Secretary and Congress which possessed Price and Pitt three-quarters of a century before in England. It was not the only instance in Civil War finance, as has been seen, in which the disproved financial techniques of earlier times were revived. It was, of course, a far less serious matter than that of the issuance of fiat paper money, but it was another evidence that the experience of the past was unknown or unheeded by those in positions of responsibility.

During the war the sinking-fund clause was a dead letter: there was no compliance with its provisions. In 1865 Secretary McCulloch expressed the matter in simple terms: "As long as it is necessary for the government to borrow money, and put its

[14] *Ibid.*
[15] Ross, *op. cit.*, pp. 383-384.
[16] 12 Statutes 345.
[17] Ross, *op. cit.*, p. 389.

obligations upon the market for sale, the purchase of these obligations for the purpose of creating a sinking fund would hardly be judicious."[18] He anticipated that a surplus in the following year would make it feasible then to meet the provisions of the law, but at the same time he recommended the repeal of the sinking-fund clause, for "the safe and simple way of sinking the national debt is to apply directly to its payment the excess of receipts over expenditures."[19]

The anticipated surplus became a reality during the remainder of McCulloch's term, and an amount of debt far greater than that required for the sinking fund was paid. This was satisfactory debt management, and there seems to have been no particular complaint that the technical provisions of a formal fund had not been put effect.[20] It was odd, however, that McCulloch, who was a trained lawyer, a careful banker, and a financier as sensitive to the refinements of credit and good faith as any then living, had no compunction in ignoring the contractual nature of the statutory sinking fund. As a matter of policy this did no harm, for the same amount of debt would have been paid in any event.

As a matter of principle, however, the foolish technical arrangement should have been set up, for although the belief in its efficacy was unenlightened, it was a part of the bargain which the government as borrower had entered into and which the Secretary was bound to acknowledge on the assumption that some poor lenders, at least, would want it kept.[21] Had Congress followed his suggestion and repealed the clause—so long as the public welfare was in no way seriously concerned—it would have been improper legislation in the same sense that the repeal, during the war, of the provision for the convertibility of the greenbacks was reprehensible. To criticize McCulloch in this respect is but to be reminded of his able, conscientious, and courageous management of the debt in other broader ways.

The Revival, Operation, and Reinterpretation of the Sinking-Fund Law

The sinking-fund clause, practically forgotten, was remembered

[18] *Treasury Report*, 1865, p. 37.

[19] *Ibid.*

[20] Ross, *op. cit.*, pp. 389-390.

[21] When the sinking-fund provision was made part of the law in 1862, 'it was a formal notice to all persons who should loan to the government, of its future intention, and constitutes a contract as binding as any can be made between it and the persons who have loaned to the Government since that date" (*Bankers' Magazine*, XL, April, 1886, 725).

by Secretary Boutwell,[22] who, soon after his accession to office, established the fund. Purchases of bonds were first made for it on May 11, 1869.[23] It was his intention that the fund represent compliance with the statute from the beginning of his own term of office, for he did not feel that he was obliged "to make any provision for the time that elapsed after the passage of the act and previous to the commencement of the present administration."[24] Bonds purchased with additional surplus revenues beyond the requirements of the fund were placed in a special fund, while the Secretary recommended to Congress that these and all future purchases be added to the sinking fund "until the gross amount shall constitute a fund equal to that which would have been created if there had been no delay in the execution of the law."[25] Boutwell was aware of the illusory nature of the scheme as Congress had enacted it, but he felt that the government was bound to undertake it. He later wrote of this particular debt-management policy:

> The step that I then took was in obedience to the law, and not from any great faith in the wisdom of the Sinking Fund policy, nor was it from any fear that the Government could not pay its debts whether a Sinking Fund was or was not created.
>
> The faith of the Government had been pledged to a particular policy and I thought that the observance of that policy was both wise and just.[26]

In the Refunding Act of July 14, 1870, the sinking-fund arrangement was somewhat simplified, although not fundamentally changed. This legislation provided that bonds acquired for the fund should be recorded and then canceled and destroyed and that the amount of interest which would have accumulated on them each year should be added to the yearly sinking-fund requirement.[27] A clear statement of the fund was especially desired "not only as a matter of correct accounting, but more especially for the information of the people, that they may see exactly how the sinking fund has increased, and to what extent and how far it is reducing the debt."[28] Thereafter in each annual Treasury report appeared a

[22] Ross, *op cit.*, p. 390.
[23] *Report of the Treasurer of the United States,* 1869, p 238.
[24] *Treasury Report,* 1869, p xiii.
[25] *Ibid.*
[26] Boutwell, *Reminiscences,* II, 137-138.
[27] 16 Statutes 272.
[28] *Congressional Globe,* 41st Cong. 2d Sess., July 1, 1870, p. 5070.

concise statement of the fund's status and its progress during the year.

By the end of fiscal 1872 the amount of bonds purchased by the Treasury was so far in excess of the sinking-fund requirements that there had been no test of the feasibility of such a device in giving support to the public credit. Since its inception in 1869 some $99 million had been purchased for the fund and $173 million in addition to this had been acquired.[29]

The attitude toward the sinking fund of the secretaries who followed Boutwell varied considerably. Richardson simply carried out the policy of his predecessor. Bristow took a very strict view of the matter, believing that the statutes imposed upon him "the imperative duty to take care of the sinking fund," that its requirements were "secondary only to the payment of interest on the public debt," and that "It takes precedence of all other appropriations."[30] During the fiscal year 1875, however, few bonds could be purchased below par, and the Secretary was not allowed to pay more. This impasse was broken by the Act of March 3, 1875, by which Congress permitted him to call in and redeem five-twenties for sinking-fund purposes. Nevertheless, not enough bonds were presented for payment before June 30 to meet the full requirement of the fund for that year.[31]

Secretary Morrill had occasion in his annual report to review the operations of the sinking fund from July, 1862, to June, 1876, and in doing so showed for the period that debt reduction had *exceeded* the requirements of the fund by $223 million. He concluded:

> It can therefore be said, as a matter of fact, that all of the pledges and obligations of the Government to make provision for the sinking fund and the cancellation of the public debt have been fully met and carried out.[32]

This was a somewhat more liberal view in that it did not stress the yearly necessity of acquiring a particular amount of bonds for the fund, if the fund were to remain inviolate.

Secretary Sherman took an even more liberal attitude. Follow-

[29] *Treasury Report*, 1872, p. ix.
[30] *Ibid.*, 1875, p. x.
[31] *Ibid.*, 1875, pp. x-xi.
[32] *Ibid.*, 1876, p. x.

ing the crisis of 1873, surplus revenues to the end of fiscal 1879 were not sufficient to meet the full requirements of the fund.[33] Besides this, under Sherman's direction the Treasury was undertaking to sell bonds for specie in preparation for resumption. The oddity of buying in bonds for a sinking fund while selling other bonds led some observers to suggest that "the claims of the sinking fund should be suspended."[34] Instead of doing this, it was held proper to credit redeemed greenbacks and fractional currency to the fund and assume that they bore a hypothetical rate of 5 per cent while so held.[35] This merely ameliorated the annual deficiencies which were allowed to accumulate until large surplus revenues wiped them out between 1880 and 1882.[36]

As Sherman conceived the matter, sinking-fund payments were to be made "out of the surplus revenues of the government."[37] He believed that if in some years the full requirements of the fund were not met, but that if in other years the deficiency were made up, "The requirements of the sinking fund law have been substantially observed."[38] Subject to this interpretation, the law should be strictly adhered to, Sherman insisted, and he urged "the importance of meeting the obligations created by these acts."[39] It was not a part of his policy to ignore the sinking fund as McCulloch had done.

Common Sense and the Sinking Fund

Sherman's construction of the sinking-fund law prevailed long after his term of office in the Treasury. That it was "consonant with common sense and sound finance"[40] is apparent. It did not, however, represent a strict fulfilment of the contract between the government and its creditors. The fault lay in the law itself rather than in the administration of it. All that the Secretaries of the Treasury could do under its provisions was to reduce the debt by the amount that surplus revenues permitted. If Congress had made

[33] Yet in the last four of these years of sinking-fund deficiencies the public credit was improving, and the refunding of the debt was carried on at successively lower rates of interest.

[34] Ross, *op. cit.*, pp. 392-394.

[35] *Ibid.*; and *Treasury Report*, 1877, p. iv; 1878, p. iv; 1879, p. iv.

[36] *Ibid.*, 1880, p. iv; 1881, pp. iii-iv; 1882, p. iv.

[37] *Ibid.*, 1879, p. viii.

[38] *Ibid.*, 1880, p. iv.

[39] *Ibid.*, 1879, p. viii. See also Sherman, *Recollections*, II, 876-877.

[40] Ross, *op. cit.*, p. 393.

the annual appropriation to the sinking fund a claim upon the revenue prior in importance to that of other appropriations, it might have given more validity to the contractual nature of the legislation.[41] It is easy to suppose, however, that if a reduction of some other desired appropriation were threatened, resort would be had to borrowing, and the position of the debt would be in no way improved through the operations of the fund under such circumstances.

This has been the experience with the formal mechanism of such funds, not only during and after the Civil War, but throughout history. Their nature can hardly be made consistent with practical fiscal policy in times of diminished revenues. It is this fact that makes the strict requirements of the formal sinking fund an illusion. What the establishment and continuance of such a fund may do to enhance the public credit under favorable circumstances is more than counterbalanced by the practical failure of the arrangement when the government's credit most needs support. Experience has repeatedly shown that it is a false aid to those financiers who would rely upon it. Professor Ross has well said that "no financial task has so befooled statesmen and led to costly mistakes, as the sinking of public debt."[42]

Under the clear and simple plan of debt reduction which Gallatin advocated—a permanent appropriation for debt reduction which in time of emergency may be diverted to other needs—the advantages of the formal sinking fund may be had without its disadvantages. This simple sort of fund, when suspended in time of emergency, automatically makes available additional funds before resort is had to new taxation. As Shirras has pointed out, this is a benefit enjoyed by a country which systematically reduces its debt.[43]

[41] *Ibid.*, pp. 393-395.
[42] *Ibid.*, p. 396.
[43] *Science of Public Finance*, II, 854.

CHAPTER IX

The Exemption of Government Securities from Taxation

To MANY people it seemed unjust that the burden of debt service and debt reduction was not shared by the wealth and income which the government's obligations represented. As it was generally conceived, on the basis of judicial interpretations, states and municipalities did not have the power to tax either the principal or the interest of the Federal debt. Thus the debt became entirely free of taxation upon the termination of the inheritance tax in 1870 and the income tax in 1872.[1] When, upon the suggestion of Secretary Boutwell,[2] Congress made tax exempt all bonds authorized by the Refunding Act of 1870,[3] it established a policy which continued until the limited exemptions of the Second Liberty Loan and the subsequent loans of World War I.[4] But the debt burden was not as extremely shifted as many opponents of tax exemption asserted. Without this feature other inducements, or less favorable terms to the government, would have been necessary to negotiate the loans, and the direct burden of debt would have been considerably greater.

The Tax-Exemption Controversy

The desire of investors for the tax-exemption provision appears to

[1] Ratner, *American Taxation*, pp. 20, 67-68, 70, 77 n., 86, 128-135.
The income tax was adopted in the Act of Aug. 5, 1861 (12 Statutes 309). Income from United States securities was favored with the special low rate of 1.5 per cent. This preference was continued until passage of the Act of June 30, 1864 (13 Statutes 281), when tax rates were made the same for all income regardless of its source.

[2] *Treasury Report*, 1869, p. xvii.

[3] When the bill was being debated in Congress, Senator Sherman explained that the bonds should be made entirely tax exempt because those held in Europe would be free from taxation anyway, incomes under $1,000 were already exempt, the bonds then held by national banks were taxable, and in the opinion of the Finance Committee the amount of taxes received would be relatively small compared with the gain to the government in being able to sell the bonds at a lower rate (*Congressional Globe*, 41st Cong., 2d Sess., Feb. 28, 1870, p 1591).

[4] Love, *Federal Financing*, pp. 218-219.

have been due, in part, to the fear that without it Federal and state taxation might at some time become confiscatory.[5] Both the advantages and disadvantages of tax exemption were overemphasized.[6] It was, certainly, a far less important matter at a time when the states relied almost entirely on the property tax, and before the permanent adoption of an income tax by the Federal government. As an aspect of debt-management policy, it became, nevertheless, a significant issue in the controversy between various classes and interests.

One of the demands which the farming and wage-earning classes made as they found expression for their views in political organization was for taxation of government bonds.[7] Strong opposition to the exemption was also expressed by the journalistic representatives of various commercial and financial interests, for it was mainly individuals of established wealth, and financial institutions with conservative portfolios, whose interests were favored by this feature of the debt. In the *Commercial and Financial Chronicle* objection was made to the provision of the Refunding Act which exempted government obligations "from all taxation of every sort."[8] The same opinion was expressed in the *Merchant's Magazine and Commercial Review:*

> This unwise and unjust exemption will do more to make the national debt odious, and endanger its utter repudiation, than anything else whatever. The change should, therefore, be made as soon as it can be legally and honorably done.[9]

A leading contemporary economist, writing in 1866, insisted that the good faith of the government be preserved with regard to exist-

[5] "Should a government reserve the right to tax its own bonds, the uncertainty attaching to such property would depress its price." "It may be said that the purchasers pay their tax in the enhanced price they pay for the bonds" (Adams, *Public Debts*, pp. 232, 233).

Under some circumstances taxation by the issuing government may be a form of partial repudiation. Cf. Shirras, *Science of Public Finance*, II, 863.

[6] Robert A. Love is of the opinion that the influence of tax exemption on the sale of bonds has probably been overestimated, but that at the beginning of a war "the exemption may . . . remove obstacles to purchasing by acting as an insurance against future taxes of unknown proportions." He says, however, "Since the bonds are sold on a one-price basis, it appears that this situation would logically result in a portion of the purchasers enjoying a surplus over and above the necessary inducement. For this reason all of the government's loss is not effective in producing desired results. Accordingly, tax exemption and progressive taxation are decidedly not to be considered as team-mates" (*op. cit.*, pp. 219, 219 n., and 220 n.).

[7] Buck, *The Agrarian Crusade*, p. 89.

[8] XIII (Aug. 26, 1871), 261.

[9] LIII (July, 1865), 32.

ing obligations, but pointed out that most of the debt would fall due within three years and all of it would became redeemable within seven years and that Congress might readily provide for its conversion into "bonds not exempt from general taxation."[10]

Better far to pay a high rate of interest, if need be, than have so large a share of individual income, and consequently of ability to pay taxes, escape its proper responsibilities. This is desirable not only as a matter of policy, in removing a prominent cause of popular dissatisfaction, which may sooner or later endanger the security of the Debt itself but as an economical advantage to the country.[11]

The relative importance of tax exemption in terms of the total economy was demonstrated by this same authority:

The national debt, if included in the national valuation would increase it 20 per cent., or from 15 to 18 billions. This would reduce the rate of taxation by one-sixth or 16 ⅔ per cent.; that is if only property was taxed, the rate would be 2 per cent., if property and national stocks, the rate would be 1.66.

Should the national debt be exempted from taxation there will be 180 millions of *income* that will go untaxed, and that . . . is a large share of the *net income* of the whole nation . . . .[12]

The Advantages of Tax Exemption

It was not, however, merely a question of more equitable distribution of the debt burden. Nor was the establishment of tax exemption as a characteristic of Federal financing the achievement of selfish pressure groups acting upon the debt-management policies of the government. Three controlling considerations influenced the adoption and continuation of this policy: the direct cost of government borrowing, the rapidly expanding market for United States bonds in Europe, and the prejudice to the sovereignty of the Federal government if states and municipalities were free to tax its obligations. Two separate questions were involved: the first, whether the government should tax its own obligations; the second, whether the states and other political units might be permitted to tax them.

The cost of borrowing was an important consideration. When Secretary Boutwell began his refunding program with the offer of

[10] Amasa Walker, "Taxation of Government Bonds," *Merchant's Magazine*, LIV (June, 1866), 409-410.

[11] *Ibid.*, p. 410.

[12] *Ibid.*, p. 409.

5-per-cent consols, there was widespread doubt that their sale could be effected at this rate, even within the country.[13] Yet taxation of bonds would certainly make necessary a higher rate of interest on forthcoming issues. In 1865 Secretary McCulloch had estimated that if local taxation were allowed the rate would have to be at least 8 per cent.[14] Four years later, in arguing the same question, Boutwell pointed out that if government obligations were subject to local taxation

> . . . the amount of the taxes imposed by the local authorities will be added to the interest the government will be required to pay, and thus the nation will be compelled to provide for taxes imposed by the local authorities.[15]

It was evident also that different tax rates in different states would prevent a general distribution of the debt except at a very high rate of interest.[16]

Both secretaries made a clear distinction between state and local taxation and Federal taxation in this connection. McCulloch suggested that Congress might consider Federal taxation to counterbalance possible inequities resulting from state-tax exemption,[17] and Boutwell was not opposed to subjecting to the income tax interest on all bonds held by Americans.[18] With both government bonds and national banks free from taxation by the states a considerable source of revenue was denied them.[19] To compensate them and yet maintain uniform investment desirability for the bonds in every state, McCulloch proposed that the debt eventually be entirely funded into 6-per-cent bonds, 5 per cent to be paid to the owners and 1 per cent on the total outstanding to be paid to the states according to their population.[20] This suggestion was not acted upon.[21]

Just as important as the matter of cost was the fact that Europe had become an important market for United States bonds. This meant that bonds bearing interest sufficient to make them attractive in the domestic market would be highly desirable outside the

[13] *Commercial and Financial Chronicle*, XII (Feb. 11, March 11, 1871), 167, 292; *Nation*, X (Jan. 27, 1870), 52-53.
[14] *Treasury Report*, 1865, p. 26.
[15] *Ibid.*, 1869, p. xvii.
[16] *Ibid.*, 1865, p. 26.
[17] *Ibid.*
[18] *Ibid.*, 1869, p. xvii.
[19] Love, *op. cit.*, p. 112.
[20] *Treasury Report*, 1867, p. xxxi.
[21] The proposed payment was ridiculed as a "puerile device . . . preposterous . . . absurd" (*Merchant's Magazine*, LVIII, Jan., 1868, 25).

United States, where no tax applied. Thus, bonds at the higher rate would be sought by Europeans, and the revenue from the tax would be lost.

> They would be rapidly transferred to other countries, into the hands of foreign capitalists, and thus at last the burden of paying a high rate of interest would be left upon the people of this country without compensation or alleviation.[22]

Another consideration which strengthened the position of those who favored tax exemption referred to the sovereignty of the Federal government. Secretary Boutwell stated it thus:

> Inasmuch as the ability to borrow money may, under some circumstances, be essential to the preservation of the government, the power should not, even in times of peace and prosperity, be qualified by any concession to the States of the right to tax the means by which the national government is maintained. The right to use its lawful powers free of any condition, restriction, or claim of another, is an essential condition of sovereignty, and the national government should never surrender or qualify its power in this particular.[23]

More than a decade later an economist writing for a standard work on political economy referred to the taxation of Federal bonds by the States as

> . . . a foolish proposition, and one that would practically give to the states the right to nullify by taxation the power of the national government to borrow money.[24]

Since intangible property was not taxed under the general property tax, the matter of exemption from state taxation was of academic or psychological, rather than financial, significance. The real importance of the tax-exemption issue came to the fore some fifty years later, when Federal income-tax rates became highly progressive. Then tax exemption became an exceedingly valuable privilege.

Whatever the merits of tax exemption, the fact remained that it prevented a considerable part of the intangible property and the income of the country from sharing the burden of the debt.

[22] *Treasury Report,* 1865, p. 27.
[23] *Ibid.,* 1869, p. xvii.
[24] Ford, in Lalor's *Cyclopaedia,* III, 559.

CHAPTER X

Monetary Policy in Relation to Debt Management, 1865-1868

DEBT MANAGEMENT was unavoidably concerned with such matters as contraction and expansion of the currency, the use of private credit, the level of prices, the relation of the volume of money to the funding and repayment operations, the return to specie payments, the relative burden of the debt upon the people, and—in more general terms—the financial welfare of the whole economy. Inherent in this close relationship of the debt, the money supply, and the level of prices was the possibility of modifying the burden of the debt, both immediately and for the future, through debt and monetary policies. As these policies affected the amount of interest paid on the debt, as they affected the incomes of the people out of which the interest payments were met, and as the purchasing power of the people was increased or decreased, the burden of the debt was made lighter or heavier. At the end of the war the resumption of specie payments was regarded as the most important means for removing the inflationary part of the debt burden.

At first, in order to prepare for resumption, and gradually to bring prices down from the relatively high level at which they continued after the war, a policy of careful contraction of the currency was undertaken. In conjunction with this and with the preliminary funding operations the Treasury sought to maintain a firm control over the entire money market. When strong opposition to contraction developed, Congress forced the Treasury to abandon the principal feature of the policy, namely, reduction of the greenback circulation.

With a change in the administration, all aspects of contraction were rejected. Emphasis then fell upon debt reduction rather than monetary policy. At times currency expansion instead of contraction was allowed to take place, and the goal of resumption was put

into the distant future. The contraction policy had held inflation in check, but the later policies of the Treasury tended to encourage it. After the great deflation of prices resulting from the panic in 1873 serious attention was again given to the problem of resumption. Throughout the whole period a heated controversy over the question of whether to contract or expand the currency influenced the government's policies, hampered and delayed restoration of the paper currency to its full value, and weakened the public credit.

Against the background of national expansion, the alternation of prosperity and depression, and the great industrial and capital development which was taking place, the proper objective of government monetary policy was twofold: first, to mitigate the evil effects which the size and character of the debt produced on the supply of money and credit, and second, so far as possible, to maintain financial stability and encourage sound business development. The circumstances under which these objectives were pursued, and the deviations from them, are considered in this and the following chapter.

The Currency

KINDS AND AMOUNTS OF CURRENCY

Technically, between 1865 and 1879 the currency of the country included gold and silver coin, gold and silver certificates, fractional currency and coin, national-bank notes, certificates of deposit, legal-tender United States notes (greenbacks), and other legal-tender obligations which had been issued during and shortly after the war.

As a result of the suspension of specie payments by the banks and then by the Treasury, and the passage soon afterward of the Legal-Tender Act of February 25, 1862, gold coin ceased to circulate as common currency. Its three principal remaining uses were for payment of customs duties, payment of interest on the government's bonds, and settlement of international balances. Instead of serving as currency, gold was a commodity bought and sold at a premium in terms of the government's paper money. Until 1873, the silver dollar was practically an unknown coin.[1] The gold certificate, being a Treasury receipt for the actual metal, afforded great convenience in handling, transfer, and storage. Like the metal it-

[1] Between 1797 and 1806 it had been exported by speculators. From 1806 to 1836 none were coined. After 1836 its mint ratio was such that it commanded a premium over gold, its circulation as money thereby being prevented. See Horace White, *Money and Banking; Illustrated by American History* (2d ed.; Boston: Ginn & Co., 1902), p. 36.

self, it was subject to the same economic law which operated to remove gold coin from general circulation. The silver certificate did not come into use until 1878.[2] Wartime and postwar legal-tender obligations other than greenbacks were all redeemed or converted into bonds and 3-per-cent loan certificates by 1868. Certificates of deposit, in effect receipts for greenbacks deposited with the Treasury, were issued in large denomination to banks for use in their reserves and in settling clearing-house balances.[3] Thus the principal circulating media throughout this period were national-bank notes, greenbacks, and fractional currency and coin.[4]

On August 31, 1865, when the debt was at its highest point, the following kinds and amounts of currency and of interest-bearing legal-tender obligations, which to some extent circulated as currency, were outstanding:[5]

United States notes (legal tender)	$433,160,569.00
Five-per-cent notes (legal tender)	33,954,230.00
Compound-interest notes (legal tender)	217,024,160.00
Fractional currency	26,344,742.51
National-bank notes	171,321,903.00[6]
State-bank notes	78,867,575.00[7]
Total	$960,673,179.51

[2] William F. DeKnight, *History of the Currency of the Country and of the Loans of the United States from the Earliest Period to June 30, 1896* (Washington: Government Printing Office, 1896), p. 109.

[3] *Ibid.*, p. 108.

[4] Before the war the currency of the United States had consisted of gold, subsidiary metal coins, and state-bank notes.

[5] For the first four items in this tabulation, see *Treasury Report*, 1867, pp. iii-iv. Other analyses of the currency for about this time have been made by Mitchell and by Shultz and Caine. Mitchell's tabulation, as of June 30, 1865, is more minute, and includes the total amount of outstanding certificates of indebtedness and the 7.3-per-cent notes, both of which he recognizes as contributing only in a measure to the volume of circulation. See Mitchell, *A History of the Greenbacks*, p. 179. In the analysis made by Shultz and Caine the various elements of the currency are itemized as of June 30 for the years 1865-1880, and for selected years thereafter. See Shultz and Caine, *Financial Development of the United States*, pp. 350, 374.

Here the purpose is to present currency figures as of August 31, 1865—the date on which the debt was at its highest—or as near that day as possible, and to tabulate only those elements of the currency which were primarily so used or which, through their employment as bank reserves, permitted more of the greenbacks to circulate. The total amount passing from hand to hand at any one time was much less than the total shown here, for large amounts were held by financial institutions, and more than $56 million was held in the Treasury, as of October 1, 1865. See *Report of the Comptroller of the Currency*, 1865, pp. 63-64.

[6] As of October 1, 1865 (*Report of the Comptroller of the Currency*, 1865, pp. 63-64).

[7] *Ibid.*

In addition to these currency items, approximately $150 million in gold coin was outstanding, most of it being either hoarded or traded as a commodity,[8] while bank deposits, also an important form of currency, contributed increasingly to the money supply as the use of bank checks was extended and the mechanism for their clearance and collection became more efficient.

BANK-NOTE, COIN, AND "DEPOSIT" CURRENCY

By 1865 state-bank notes were rapidly being withdrawn from circulation and replaced by national-bank notes. On June 30, $143 million worth of them was still in circulation, but a year later their total had dwindled to $20 million.[9] In subsequent years the few that remained unredeemed could hardly be considered a part of the currency. The account of this feature of Civil War finance, whereby the national banking system was established and the state-bank notes were taxed out of existence to be replaced by national-bank notes, is well known. Although this transition from one kind of currency to another resulted in some increase in the total amount in circulation, it was largely a displacement of one by another. Much more significant was the relationship of the new form of the currency to the debt.

In this regard two important characteristics of the national-bank notes may be observed. They were, of course, secured by bonds of the government. Moreover, their worth was dependent upon the status of the public credit both because of the bonds which secured their issue and because, specie payments being almost everywhere suspended,[10] they were redeemable only in greenbacks, the changing value of which necessarily determined the value of the national-bank notes. They were secured by one form of debt and made redeemable in another.

The national-bank notes were widely recognized as a form of currency far superior to the bewildering assortment of state-bank notes which they replaced. Among the various merits ascribed to them at the time of their authorization, an important one to Secretary Chase and the financial committees of Congress, was that the national banks, in meeting the requirements for their issuance, would be obliged to acquire a large amount of government bonds.

[8] Shultz and Caine, *op. cit.*, p. 350.
[9] *Ibid.*
[10] Massachusetts and California continued to pay the interest on their bonds in gold (*Treasury Report*, 1867, p. xxix).

Chase estimated that a market for perhaps $250 million of war bonds would thus be created.[11] A total of $300 million of national-bank notes had been authorized, but it was not until 1866 that the circulation of this amount was approximated. The notes had been apportioned by states according to their national-bank capital and according to their population as shown in the 1860 census. With the rapid growth of population in the West, however, a change in this arrangement became necessary. It was brought about by the Act of July 12, 1870,[12] which authorized an additional $54 million for banks in states and territories "having less than their proportion," and provided for the withdrawal of $25 million in excess circulation from those states where it existed. By 1873 nearly $340 million worth of them was in circulation.[13]

Two other provisions of this same enactment affected the volume and the nature of the currency. One was for the redemption of the 3-per-cent loan certificates in an amount equal to the additional national-bank notes authorized. The other met the desire of Californians for a bank-note circulation expressly redeemable in gold coin. It permitted the organization of national banking associations for this purpose and authorized these banks to issue such notes up to 80 per cent of the amount of Federal bonds deposited by them with the Treasury. They were required to keep a reserve of gold or silver coin equal to 25 per cent of their outstanding circulation. The notes were to "bear upon their face the promise of the association to which they are issued to pay them . . . in gold coin of the United States." No limit was placed upon the total amount of these notes, although one banking association could issue no more than $1,000,000.[14] Altogether there were issued about $3.5 million of these national-bank notes redeemable in gold.[15]

An important modification in the national-banking currency was introduced in the Resumption Act,[16] when all the existing limitations on the maximum amount of note issue were removed and every national bank was allowed to issue notes to any aggregate amount, provided it deposited with the Treasury the requisite amount of government bonds as security. The Secretary of the

[11] *Ibid.*, 1862, pp. 17-20.
[12] 16 Statutes 251.
[13] Shultz and Caine, *op. cit.*, p. 356.
[14] 16 Statutes 251.
[15] Schultz and Caine, *op. cit.*, p. 356.
[16] Act of January 14, 1875 (18 Statutes 296).

Treasury was required to redeem an amount of greenbacks equal to 80 per cent of the additional national-bank notes that might be issued, so long as more than $300 million of the greenbacks were outstanding. The release of the national banks from restriction upon the amount of their note issues did not bring about an increase in the circulation, for depressed business conditions had reduced demand for loans and currency, and the higher price level for government bonds rendered note issue less attractive to many bankers. Some $341 million worth was in circulation in 1875, and only $301 million in 1877.[17]

Although between 1862 and 1879 the currency consisted of inconvertible paper promises to pay specie at some unspecified future time, gold continued indirectly to be the real standard of value. There was a free market for it, and it was continually quoted in terms of greenbacks. The price of each in terms of the other may be said to have fluctuated, but gold was by far the more stable commodity and paper promises the more erratic.

The value of the latter depended from day to day on how much men valued those promises and how much they desired to acquire gold. Why a particular price was paid for gold at any particular time is a question that cannot be answered with any accuracy.[18] Its purchase did not necessarily represent a flight from paper notes, for gold was needed to meet international debit balances and for customs duties. The supply of gold which reached the market came from the mines and from the Treasury both as interest payments on the government's bonds and through sales of surplus holdings. Psychological and speculative influences also contributed to the gold-greenback fluctuations.

A somewhat minor, but nevertheless significant, part of the currency was that form of it which circulated in denominations of less than one dollar. The Coinage Act of 1853 had provided for the minting of fractional silver coins of such weight that their bullion value was somewhat less than their face value. When, during the war, the greenbacks depreciated sufficiently in terms of silver so that silver coin was worth more as bullion than as coin, silver disappeared from circulation. The resulting dearth of small coins led to the use of postage stamps and then paper currency

[17] Shultz and Caine, *op. cit.*, pp. 374-375.
[18] See Mitchell, *Gold, Prices, and Wages*, p. 281.

issued in fractional parts of a dollar.[19] The amount in circulation tended to increase during and after the war. On August 31, 1865, the total outstanding was a little more than $26 million.[20]

The Resumption Act had directed the Secretary to mint silver coins of the quality specified in the Coinage Act of 1853 (legal tender to the amount of five dollars) and to exchange them for the fractional currency, but it was not until 1877 that greenbacks had sufficiently appreciated so that silver in the new coins was worth less as bullion than as currency.[21] At the same time the value of silver was declining. Before 1873 the silver in the old dollar was worth more than a gold dollar, but by the end of 1877 it was worth only 92 cents in terms of gold.[22] Secretary Bristow resisted the demands made upon him before that time to begin immediately the issue of silver coin.[23] The act had provided for the issue of $40 million, and this amount was increased to $50 million in subsequent legislation.[24] Thus resumption of payment in silver of that part of the paper currency represented by fractional notes preceded and aided in the preparation for resumption of gold payments on the remainder of the currency.

As one great currency problem approached solution in the revalorization of the greenbacks, another arose. Silver and silver certificates were to become an important part of the total currency and in a later period were to have a profound influence upon both monetary and fiscal policy. The silver controversy had begun well before 1879, although silver was an insignificant part of the currency before the turn of the decade. Nevertheless, its employment as money was so vigorously debated long before the actual use of it that the investing public at home and abroad was forewarned and disturbed.

The background of the controversy can be briefly stated. Through an oversight in the drafting of the bill which eventually became the Coinage Act of 1873, no provision was made for the minting of standard silver dollars. This did not demonetize the

[19] J. Laurence Laughlin, *The History of Bimetallism in the United States* (New York: D. Appleton & Co., 1886), pp. 82-85, 86-89.

[20] *Treasury Report*, 1867, p. iv.

[21] ". . . the 345.6 grains of silver in the subsidiary coinage were equivalent to 96.9 cents in gold" (Laughlin, *op. cit.*, p. 89).

[22] *Treasury Report*, 1877, p. xxiii.

[23] *Ibid.*, 1875, p. xxvii.

[24] Sherman, *Recollections*, I, 539, 543.

silver dollar. It simply discontinued its coinage.[25] However, in the *Revised Statutes of the United States,* adopted in June, 1874, *all* silver was limited in its legal-tender power by the following provision: "The silver coins of the United States shall be a legal tender at their nominal value for any amount not exceeding five dollars in any one payment."[26]

By 1874 the price of silver had fallen below parity with gold. This was a continuation of the secular decline which had begun in 1859.[27] When the Bland-Allison Silver Act[28] was passed over the veto of President Hayes, the value of a silver dollar in terms of gold was 93.25 cents. By the end of the year it had declined to approximately 86 cents.[29] This act was a compromise with the popular supporters of free coinage of silver. It made the silver dollar full legal tender and provided for the purchase and coinage of not less than $2 million and not more than $4 million of silver a month. In the Congressional elections that year "free silver" was the dominating issue. Although its proponents did not then obtain a clear-cut mandate from the electorate, it was apparent that the real strength of the silver movement was "the conviction of large masses of the people that the community has not enough money."[30]

The potentialities of even this limited directive to coin silver were apparent to Secretary Sherman when he recommended that the total amount should not exceed $50 million:[31]

> . . . it is indispensable either that the silver coin be limited in amount, or that its bullion value be equal to that of the gold dollar.[32]
> No effort has been spared to put this coin in circulation. Owing to its limited coinage it has been kept at par; but its free coinage would soon reduce its current value to its bullion value, and thus establish a single silver standard.[33]

Toward the end of 1878 there was concern that the silver arrangement might hamper the resumption of specie payments. The Secretary was cautioned to give the public its choice of either gold or silver when notes were presented for redemption, and not to

[25] Laughlin, *op. cit.,* pp. 92-95. [26] Sec. 3586.
[27] Laughlin, *op. cit.,* p. 251.
[28] Act of Feb. 28, 1878 (20 Statutes 25).
[29] *Treasury Report,* 1878, p. xiv.
[30] F. W. Taussig, "The Silver Situation in the United States," *Publications of the American Economic Association,* 1st ser., VII (Jan., 1892), 11.
[31] *Treasury Report,* 1879, p. xiv. [32] *Ibid.,* 1878, p. xv.
[33] *Ibid.,* 1879, p. xiv.

attempt to force silver into circulation in this way. The new currency problem—that of the coinage of legal-tender silver—threatened to prevent the solution of the long-standing problem of resumption. Professor White, an authority on money and banking at that time, referred to the Bland-Allison Act as "the most mischievous piece of legislation that could have been devised to embarrass and jeopardize the intended resumption of specie payments."[34]

Deposit currency, that is, bank deposits transferable by means of checks, became an increasingly important part of the currency supply. The inelastic nature of the greenbacks and the national-bank notes encouraged greater use of bank checks. The concentration of population in urban centers, improved communication, and cheaper postage rates also facilitated the transfer of bank deposits by this means.[35] As a result, less hand-to-hand currency was required in a given period of time for the transaction of a particular volume of business.

Actually, well before the Civil War, deposits had exceeded bank-note currency.[36] After the war they increased rapidly. The extent of this rise in the total deposits of all banking organizations in the United States was as follows (in millions of dollars):[37]

1865	$ 698.0
1870	1,064.5
1875	1,797.2
1879	1,946.3

In the early years after the war there was a large potential source of deposit currency in the banking system, for the reserves of all the banks exceeded by about one-third the actual reserve requirements. On the basis of this excess, a large expansion of bank deposits was continually possible, for each dollar of reserve could support about four dollars of deposit currency. Over a period of years these excess reserves steadily declined until in 1873 they were fairly close to actual requirements.[38] By the Act of June 20, 1874,[39] however, banking reserves received a tremendous increase when

[34] Horace White, "After Specie Resumption—What?" *International Review*, V (Nov., 1878), 833-835.

[35] Walter Earl Spahr, *The Clearing and Collection of Checks* (New York: The Bankers Publishing Co., 1926), p. 84.

[36] *Ibid.*

[37] *Ibid.*, pp. 84-85.

[38] Margaret G. Myers, *The New York Money Market*, Vol. I: "Origins and Development." (New York: Columbia University Press, 1931), pp. 235-236.

[39] 18 Statutes, pt. 3, 123.

it was provided that the amount of a bank's outstanding notes need no longer be considered in computing the reserve. This action released some $44 million of greenbacks.[40]

The developing use of the bank check economized the use of currency and enabled banks to transact their daily business with a smaller amount of till money. It also provided an elastic form of currency which could expand and contract according to the requirements of business. The effect of government monetary policy upon the volume of deposit currency took place through its influence upon bank reserves.

GOVERNMENT DEBT AS CURRENCY

The legal-tender interest-bearing obligations served more as a form of investment than directly as currency. Yet the 5-per-cent notes tended to enter circulation following interest-payment dates and were then reabsorbed by banks and investors as interest on them again accrued.[41] By December, 1865, however, they had been redeemed or converted into compound-interest notes.

The compound-interest notes tended to circulate less as interest on them accrued. Being eligible as a part of the banks' reserves, the large denominations especially were so used, thereby freeing greenbacks for circulation.[42] In the postwar conversion operations, the exchange of these legal-tender notes for the five-twenty bonds was regarded as a step in the direction of currency contraction. According to one estimate, by the end of 1865 not more than 5 per cent of them were in active circulation.[43] Nevertheless, their redemption or conversion into bonds had the effect of contracting the currency to a much larger extent than the amount indicated by their circulation, for legal-tender notes had to be drawn in by the banks to take the place of the compound-interest notes in their reserves. It was this consideration which influenced Congress in March, 1867, and July, 1868, to authorize the 3-per-cent loan certificates to be used in conversion of the legal-tender compound-interest notes, for the certificates, unlike the five-twenty bonds, could also be used as a part of the banks' reserves. These two enactments,

[40] Myers, *op. cit.*, pp. 235-237.

[41] Bolles, *Financial History, 1861-1885,* pp. 124-125; Dewey, *Financial History,* p. 312.

[42] *Merchant's Magazine,* LIV (Feb., 1866), 126; *Commercial and Financial Chronicle,* III (Sept. 15, 1866), 322.

[43] *Report of the Comptroller of the Currency,* 1865, pp. 66-67.

as has been shown, were primarily anticontraction currency measures rather than conversion legislation, as they might have seemed. The last of the compound-interest notes became due on October 16, 1868. Because of the substitution of the certificates for some $75 million of them, their elimination both as debt and as actual and potential currency thus did not reduce the currency total by the amount withdrawn.

Another element in the currency was that part of the short-term non-legal-tender debt which, although it bore interest and was primarily a medium for investment, passed from hand to hand to some extent, as if it were currency. Some part of the 7.3-per-cent notes and the one-year 6-per-cent certificates of indebtedness were used in this way, although just what volume of them at different times cannot be estimated.[44] At one point the 7.3-per-cent notes had actually been dispersed to those soldiers willing to accept them as pay.[45] They were also used to settle obligations to many contractors.[46] To a person who wished to pay a debt there was little difference whether he sold a small-denomination government obligation to obtain the needed funds or simply transferred it to a creditor willing to accept it. Some readers may recall the similar use occasionally of small-denomination Liberty bonds during and after World War I.

Another part of the debt which served as currency was the United States notes, $450 million of which had been authorized by Congress in 1862 and 1863. They were of indefinite maturity and bore no interest. These "greenbacks," as they came to be known, were legal tender in payment of all debts, public and private, within the United States, except duties on imports and interest on the public debt. At the time of their authorization they were regarded as a temporary obligation of the government that would be promptly repaid as soon as the exigencies of wartime finance were passed. They were considered as much a part of the Federal debt as any other obligation of the government. That they were purely and simply a form of fiat money—a forced loan from all the people—and that their issuance was contrary to the teachings

[44] Mitchell, *History of the Greenbacks*, p. 178 ff.; Barrett, *The Greenbacks*, pp. 132-133.

[45] *Treasury Report*, 1864, p. 21.

[46] *Commercial and Financial Chronicle*, I (Oct. 7, 1865), 449; Oberholtzer, *Jay Cooke*, I, 518-524.

of financial experience both in this country and abroad, were secondary considerations even in the minds of some who were informed in matters of finance. The war emergency had been the dominating consideration when they were issued.

The role to be played by the greenbacks in the national economic life, the controversies which they engendered, and their perpetuation, even to this day, as a part of the currency, were not foreseen when they first passed from hand to hand as a convenient medium of exchange, gradually depreciating in terms of gold and other desirable goods. These greenbacks were the primary problem of monetary policy in the postwar era.

The Relation of the Independent Treasury to the National Banks and the Money Market

Two circumstances which made the effect of debt-management operations on the money market direct, strong, and sometimes awkward to control, were the nature of the Independent Treasury system and the unit system of banking. The Treasury was, in a very real sense, its own banker. There was no central bank. The government's monetary policies were necessarily adapted to the limitations and requirements of these institutions.

When Congress had permanently established the Independent Treasury in 1846,[47] the cumbersome system was justified by the nature of the state banking system, to which the term "wild cat" was often applied.[48] The act completely separated the government from the banks and committed it to the use of specie. "It made the government distinctly its own banker, essentially and actually, even to the furnishing of the paraphernalia of office-room."[49] It required that "all public officers should safely keep the public money committed to their charge without depositing it in banks."[50] Since the law also permitted the issue of Treasury notes, it made the Treasury in effect a bank of issue.[51] Strict constructionists of the Constitution[52] insisted that the Independent Treasury system was the only legal way in which the government's funds could be handled.[53]

[47] 9 Statutes 59.
[48] Kinley, *Independent Treasury*, pp. 8-39.
[49] *Ibid.*, p. 42. [50] *Ibid.*, p. 43. [51] *Ibid.*, p. 42.
[52] "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law" (Article I, Section 9).
[53] Kinley, *op. cit.*, p. 36.

When the Treasury suspended specie payments early in 1862, the most important feature of the law—the provision that the Treasury receive and disburse only specie—was negated.[54] The National Banking Act liberalized the system by permitting the deposit with national banks of government receipts other than those from customs, by permitting the use of banks as financial agents of the government, and by making national-bank notes receivable at par in all parts of the country, except for customs duties and interest on the public debt.[55] How Chase refused to take advantage of the modification of the law which allowed certain deposits with banks, and how, during the early war borrowing, this precipitated the suspension of specie payments has been recounted.

Thus, at a time when an enormous Federal debt was in process of being converted, refunded, and paid down, and a great mass of inconvertible paper money seemed to defy every effort made toward the resumption of specie payments, there loomed in the background of all the government's fiscal operations and all the activities of the business and financial community the primitive Independent Treasury. In its place the national-banking system might well have served efficiently and safely as banker to the government, but tradition and inertia prevented this. The national banks, too, were subject to certain limitations (notably lack of centralization and the inflexibility of their note issues), but they represented a vast improvement upon state banking and the conglomeration of state bank-note issues.

Under the Independent Treasury system the Treasury and subtreasuries were a great money reservoir into which flowed funds from all parts of the country. The outward course of these funds was directed by the appropriations and authorizations of Congress and the policies of the Secretary of the Treasury. Large receipts and disbursements, the inflexible nature of the currency, and the rigid requirements of the Independent Treasury law made the fiscal operations of the government a major direct influence in the money market. Taxation, borrowing, minting, spending, and debt payment did much to determine the supply of money and credit available for business transactions within the country and with other nations. Currency drawn into the Treasury reduced the supply in the money market, and Treasury disbursements increased it.

[54] *Ibid.*, pp. 67-68.
[55] *Ibid.*, pp. 69-70.

Because of this, the business and financial life of the country was peculiarly dependent upon the Treasury. A large balance, especially at seasons of high business activity, meant a tight money market and danger to the solvency of many sound firms, for the banks could lend only up to the limit of their reserves. These reserves were reduced when the Treasury balance increased. To hold idle in the Treasury, in times of stringency, money which otherwise might have increased bank reserves deprived business of at least four times as much in credit accommodation needed for the completion of transactions. On the other hand, when an overabundance of currency and the resulting enlarged credit pyramid exerted an upward pressure on prices and encouraged speculation, Treasury policy with respect to holding and disbursing funds could encourage or restrain the inflationary trend.

There was a tendency for funds to accumulate in the Treasury, for in each year after 1865 ordinary receipts exceeded ordinary expenditures. This placed a serious responsibility upon the Secretary, yet he could not simply order the disbursement of money immediately as it became available. Both receipts and expenditures were irregular, the former bulking largest in the spring and summer, when customs duties were large, the latter being greatest on interest dates at the half- and quarter-year points. For this reason it was necessary in some periods to build up the Treasury balance in anticipation of large disbursements later. Thus it was difficult to manage the available balance in a manner that would meet the requirements of prudent finance and at the same time prevent stringency in the money market.[56] Augmenting this problem was the tendency of the conversion and refunding operations, in channeling funds through the Treasury, temporarily to deprive the business community of their use.

Since, in this period, an important part of Treasury operations was concerned with the management of the debt, the policies formulated with respect to it were necessarily conditioned by the close relationship of the Independent Treasury to all the credit institu-

[56] Myers, *op. cit.*, pp. 353-354. Many people supposed that if no surplus were held in the Treasury, no stringency in the money market could occur. The fact is, however, that the most usual cause of stringency was not the accumulation of funds in the Treasury, but the development of "some sudden or unusual demand for money entirely independent of Treasury conditions and operations." See O. M. W. Sprague, *History of Crises Under the National Banking System,* National Monetary Commission Publication (S. Doc. No. 538, 61st Cong., 2d Sess., 1910), p. 397.

tions of the country. Besides its regular fiscal functions, the Treasury was engaged, under the requirements of the law, in an "immense banking business."[57]

The deposit of government funds with national banks could have been made to play a significant part in the Treasury's relations with the money market. At a few times such deposits were resorted to as a means of facilitating the sale of bonds and the sale of gold, and in connection with the preparation for resumption of specie payments. In these instances the deposits were increased in order to prevent undue strain on the money market; and when the particular need for them had passed they were again drawn down. Even under the awkward limitations of the Independent Treasury system, deposits might have been allowed to accumulate until they were a substantial portion of total bank deposits.[58] As such, the deliberate increase or decrease in their amount by the Treasury would have rendered the money market easy or stringent, practically at the command of one person. It was due only in part to the restrictions of the Independent Treasury that none of the secretaries used this means of money-market control to any great extent (except in one instance) or as a continuous policy. Throughout the postwar period the total of Treasury deposits with the banks was small.[59]

There were several reasons for this situation. Only internal-revenue receipts could be deposited, and these only at the time collected. Funds could not, under the law, be drawn from the Treasury and placed with the banks. Although internal revenues were an important part of all revenue and amounted to a large sum over

[57] Winthrop M. Daniels, *The Elements of Public Finance* (New York: Henry Holt and Company, 1899), p. 316. "There is no more natural or necessary connection between collecting public money and banking than between running a grocery store and banking." (*Ibid.*)

[58] In 1867, for example, when the Treasury's balance of coin and currency ranged above $170 million, total deposits of national banks were about $550 million, and of all banking institutions, $910 million (*Treasury Report*, 1867, p. xxxiii; William Graham Sumner, *A History of American Currency*, New York: Henry Holt & Co., 1874, p. 212; Spahr, *op. cit.*, p. 84).

[59] According to one authority they declined from $36 million in 1865 to $8 million in 1870 and $11 million in 1875. In some years between they were less than $10 million. In the spring of 1879 deposits were permitted to rise to approximately $250 million as a precautionary measure, for the phenomenal sale of refunding bonds at that time would otherwise have drained the money market. Thereafter the deposits fell to a relatively small amount (*Report of the Treasurer of the United States*, 1903, pp. 122-128, 240-241; Myers, *op cit.*, p. 355; see also Spahr, *op. cit.*, pp. 84-86).

a period of time,[60] the amounts acquired daily, if they were deposited with the banks during a period of stringency or panic, would have been too small to help appreciably. On the other hand, if large deposits were built up, the withdrawal of even a part of them would be discomforting to the bankers who had put the funds to use. Thus the deposit of internal-revenue receipts with the banks was an unusual measure employed only in emergencies.[61]

When it was the Secretary's intention to contract the currency and restrain credit expansion, the deposit of surplus funds with the banks would have vitiated this policy. When contraction was no longer an objective, surplus revenue was released from the Treasury by the purchase of bonds. This might as easily have been done by depositing the surplus with the banks and drawing against them, thereby at no time reducing the volume of circulation, for even the lag between receipt and expenditure as money passed through the Treasury to some extent lessened the currency supply.

Doubt as to the legality of depositing funds derived from certain sources restrained the secretaries in their use of bank depositaries. When the critical condition of the money market in the autumn of 1872 made it desirable for the Treasury to sell gold to meet the needs of bankers and importers, Secretary Boutwell set a precedent by arranging for the deposit of the proceeds in New York banks.[62] When Sherman was preparing for resumption of specie payments, he obtained the opinion of the Attorney General to the effect that the Refunding Act and the Resumption Act both gave him power to leave the proceeds of bond sales on deposit with banks.[63] By so doing the sale of bonds was facilitated and the money market kept easy. Because this procedure was also followed in the spring of 1879, the great wave of demand for the last of the refunding issues created little disturbance in the money market.[64]

Secretary McCulloch's Currency-Contraction Policy

After a major war financed largely by borrowing, the adminis-

[60] Customs were the largest source of revenue. In 1861 and 1862 they had yielded 95 per cent of the total receipts of the government, but in no year between 1866 and 1879 did they amount to 60 per cent of it. Cf. *Treasury Report,* 1950, p. 450.

[61] A. Piatt Andrews, "The United States Treasury and the Money Market," *Papers and Discussions of the Twentieth Annual Meeting* of the American Economic Association, Ser. 3, Vol. IX (April, 1908), p. 219.

[62] Myers, *op. cit.,* pp. 355-356.

[63] *Ibid.,* pp. 356-357.

[64] *Treasury Report,* 1879, pp. xv-xvii.

tration faced a peculiarly difficult problem. The question was whether to contract the currency and thereby discourage speculation, reduce the price level, strengthen the public credit, and restore the value of the currency, accepting as a consequence whatever business recession might result, or whether to let excssive purchasing power exert its force until it brought about its own correction.[65] Even for men of discernment in public office, it was a difficult question. A policy of contraction, no matter how sound, was certain to encounter strong opposition, for curing the ills of inflationary borrowing required a medicine too bitter for a large part of the population and their representatives in the government to swallow. The expedient way was either to do nothing or to continue to inflate, for the early stages of the inflation resembled prosperity; and with governments, borrowing is easier than repayment.[66]

Secretary McCulloch's stand was clear and firm. As has been seen, his two immediate major objectives were the reduction and conversion of demand and short-term debt and contraction of the greenbacks. These steps, in conjunction with continuing national prosperity and the strengthening of the public credit, he regarded as the means to that greater end, namely, the resumption of specie payments.[67] In his conversion and debt-reduction operations he encountered relatively little disagreement and opposition. His strict policy of currency contraction, however, soon drew strong opposition.[68] Altogether, during his term of office, $44 million worth of the greenbacks was retired. The circumstances which surrounded this operation and the nature and effect of the opposition to it are set forth below.

THE LOST OPPORTUNITY TO RESUME SPECIE PAYMENTS

For a short time after the war, before the issues of contraction versus inflation were clearly drawn, there was an opportunity to

[65] "The war being ended the financial question took this form: Shall we withdraw the paper, recover specie, reduce prices, lessen imports, and live economically until we have made up the waste and loss of war, or shall we keep the paper as money, export all our specie which has hitherto been held in anticipation of resumption, buy foreign goods with it, and go on as if nothing had happened?" (Sumner, *op. cit.*, p. 211).

[66] It is this which underlies the almost universal experience that governments eventually debase the circulating medium and repudiate their debts. See Harry Scherman, *The Promises Men Live By* (New York: Random House, 1938), chaps. xiii-xviii.

[67] See *Treasury Reports*, 1865-1868, *passim*.

[68] McCulloch, *Men and Measures*, pp. 208-209.

resume specie payments. The wartime belief that within a reasonable period after the return of peace the greenbacks would become redeemable in gold still continued.[69] Various important economic classes within the country—businessmen, landlords, lending capitalists, and wage-earners—were in a sufficiently favorable position to endure resumption in 1865 and 1866. At this time sentiment among the people generally was strong for resumption at the earliest possible date.[70] With them the high level of prices and the consequent high cost of living was an important consideration.

Early in December, 1865, the House of Representatives resolved, with only one member voting in opposition, that

> . . . the public debt created during the late rebellion was contracted upon the faith and honor of the nation; that it is sacred and inviolate, and must and ought to be paid, principal and interest; and that any attempt to repudiate, or in any manner to impair or scale the said debt, should be universally discountenanced by the people, and promptly rejected by Congress if proposed.[71]

Two weeks later, when McCulloch officially announced his intention to resume specie payments as soon as possible and sought authority from Congress to sell bonds in order to continue the contraction of the currency on a large scale,[72] the House of Representatives resolved by a vote of 144 to 6

> That this House cordially concurs in the views of the Secretary of the Treasury in relation to the necessity of a contraction of the currency with a view to as early a resumption of specie payments as the business interests of the country will permit; and we hereby pledge cooperative action to this end as speedily as practicable.[73]

This was the high point in that series of peaks and valleys over which the course of the public credit ran. The government's 6-percent bonds, which earlier had sold as low as 38 in European markets, ranged above 65 and were being acquired in increasing amounts by English, German, and Dutch investors.[74] At the same

[69] Noyes, *Forty Years*, pp. 7-11.
[70] Barrett, *The Greenbacks*, pp. 112-131; Noyes, *op. cit.*, pp. 9-11.
[71] *Congressional Globe*, 39th Cong., 1st Sess., Dec. 5, 1865, p. 10.
[72] *Treasury Report*, 1865, pp. 12-14.
[73] *Congressional Globe*, 39th Cong., 1st Sess., Dec. 18, 1865, p. 75.
[74] *Commercial and Financial Chronicle*, II (Jan. 6, 1866), 2; Charles F. Speare, "Selling American Bonds in Europe," *Annals of the American Academy of Political and Social Science*, XXX (Sept., 1907), 271.

time, the gold value of the greenbacks had appreciated substantially, and their range of fluctuation had narrowed.[75]

Two underlying requirements which had to be met before specie payments could be resumed were that the abnormally high level of prices in the United States must be lowered and that the balance of trade had to turn in favor of the country. The latter depended, of course, upon the former. A rapid fall in prices, especially those of wholesale commodities, between January and July, 1865,[76] seemed to confirm the belief that the wartime expansion of prices had ended.

In 1865 and 1866 McCulloch did not perceive that foreign borrowing would have made resumption readily possible at that very time. The British especially, and the nationals of other countries too, were able and willing to lend, and if the proceeds of their loans had been known to be earmarked for resumption, the greatest obstacle to their confidence in American credit would immediately have been overcome.[77] The salutary results of foreign borrowing at this time would have been very great. The disrupting effects of an unstable paper money, the high rates of conversion and refunding, and the excessive interest cost of the debt for many years, might all have been avoided had not McCulloch's mercantilistic viewpoint[78] prevented him from perceiving that the exchange of American securities for European gold[79] would have been a highly profitable transaction through the financial benefits attendant upon the enhancement of the public credit.

The time was ripe for resumption. Congress had emphatically resolved in favor of it, the people expected it, and opposition had not yet crystallized and begun to exert its counterinfluence. Under such circumstances, and with McCulloch's influence, the national prejudice against borrowing abroad could probably have been overcome, as it was a few years later under Secretary Boutwell. It is not so much intended to criticize the Secretary for a provincial attitude which prevented him from perceiving the advantages in foreign borrowing at so opportune a time, but rather to demonstrate again that the course of events may, at certain junctures,

[75] Mitchell, *Gold, Prices, and Wages,* pp. 13-14.
[76] Mitchell, *History of the Greenbacks,* pp. 341-342.
[77] Barrett, *op. cit.,* pp. 138-158.
[78] *Economist,* XXIV (April 14, 1866), 439-441.
[79] It was exactly this procedure which was eventually followed in 1878 when Sherman prepared for resumption.

depend upon the point of view and the resulting decisions of one or a few men. McCulloch could not foresee the rapid change in public sentiment which was to hamper and then defeat his policy of currency contraction. He did anticipate with confidence, at a time when all circumstances seemed to justify it, that this policy would be followed and resumption achieved by July, 1868.[80]

THE ANTICIPATED EFFECT OF CONTRACTION

Those who were most uncompromisingly in favor of currency contraction admitted the belief that it would be a painful process, that readjustment of the economy to a sound condition would necessarily involve some injury to business and cause some suffering. They considered it the lesser of two evils.

That the country can possibly be restored to a sound financial condition without much suffering, is not for a moment to be supposed. No great war in modern times was ever closed without a powerful and distressing reaction. The delirium of speculation must be followed by prostration. That is unavoidable. The only question for sensible men to consider is, how the shock of returning peace shall be met?[81]

. . . the man who is burdened with debt is in imminent danger . . . . there are two maxims which may with advantage be adopted by our business men. The first is to make arrangements so as "to get out of debt," and as far as possible "to keep out"; and the second is to "stick to legitimate business," and avoid the specious, seductive, perilous paths of speculation.[82]

It is one of the embarrassments of our situation that we cannot restore our finances to a healthy condition without producing effects injurious to the business interests of the country.[83]

The evils *to be* caused by the *ap*preciation of currency are but the other side—the reverse of the evils that *have been* caused by its *de*preciation. And it is worthwhile to incur those evils, for no man can venture to give wholesome credit, and no one can thoroughly know how he stands, while the instrument of reckoning suffers daily fluctuations and is always liable to greater ones.[84]

McCulloch feared less the effects of contraction than the consequences if it were not undertaken.[85] "It is, in part, to prevent a

[80] *Treasury Report,* 1866, p. 25.
[81] *Bankers' Magazine,* XXII (Sept., 1867), 170.
[82] *Commercial and Financial Chronicle,* I (Sept. 16, 1865), 353.
[83] Newcomb, *A Critical Examination of Our Financial Policy,* p. 144.
[84] *Economist,* XXIV (April 14, 1866), 441.
[85] Hugh McCulloch, *Our National and Financial Future,* pp. 14-15.

financial crisis, that is certain to come without it, that the Secretary recommends contraction."[86] He held that although prices might fall to a lower level and government revenues might be temporarily reduced, the consumers and the poorer classes would be benefited, the public credit strengthened, and the business of the country placed upon a sound basis.[87] In his memoirs he wrote:

I have no doubt that all of the United States notes might have been gradually withdrawn from circulation without prejudice to legitimate business.[88]

He understood the nature of the money market and the automatic limitations which it placed upon a too rapid reduction in the amount of the greenbacks. Though he envisioned the complete elimination of these notes, he knew that it must be accomplished gradually. Contraction was but one strand of his debt-management policy:

Nor is there any reason to apprehend, by any policy that Congress may adopt, so rapid a reduction of prices as to produce very serious embarrassment to trade. The government currency can only, to any considerable extent, be withdrawn by a sale of bonds, and the demand for bonds will be so affected by the state of the market that a rapid contraction will be difficult, if not impossible, even if it were desirable.[89]

McCulloch was well aware of the sensitivity of the money market to Treasury policies and of the great care which had to be exercised in that relationship lest the furtherance of one part of his program be to the detriment of the whole:

. . . it was highly important that the necessity of an early return to specie payments should never be lost sight of. At the same time, it seemed to the Secretary that a return to the true measure of value, however desirable, was not of sufficient importance to justify the adoption of such measures as might prevent funding, and injuriously affect those branches of industry from which revenue was to be derived, much less such measures as might, by exciting alarm, precipitate the disaster which so many anticipated and feared.[90]

THE INCREASED NEED FOR CURRENCY AND THE REDUNDANT SUPPLY OF IT

The true guide to a policy which contemplated contraction of

[86] *Treasury Report*, 1865, p. 12.
[87] *Ibid.*, pp. 11-12.
[88] *Men and Measures*, p. 212.
[89] *Treasury Report*, 1865, p. 12.
[90] *Ibid.*, 1867, p. v.

the paper currency was to be found in the extent to which—so far as could be estimated—the circulation supported sound business activity.

The high price level had multiplied the demand in the money market for funds. Prices of all commodities had risen steeply during the war not only as the result of the great quantity of depreciated currency which had entered circulation, but also because of the scarcity which wartime consumption and the displacement of manpower had effected.[91] Wages had also risen, although less rapidly than commodity prices.[92] Because of high prices, the resulting increase in the cost of living required more currency simply to meet the needs of ordinary hand-to-hand circulation. Much more important than this, money-marketwise, was the great increase in the costs of production, especially of raw materials and labor, and the consequent high value of goods in process, in inventories, and in the channels of distribution. The high level of business activity, as well as the high prices at which it was carried on, had greatly increased the demand for currency and bank loans. Because of the fluctuating value of the paper currency and because of the general uncertainty, a larger percentage of business was transacted on a cash basis, and commercial credit terms were for shorter periods than before the war. This also increased the need for currency.[93]

What the real currency requirements of the country were was finally a matter of estimate and judgment. There was, however, considerable evidence that the approximately $900 million of actual

[91] A comparison of wholesale prices of the more important commodities at the Port of New York before and after the war shows the change that had taken place:

	1859	1865
Wheat, per bushel	$1.25	$2.70
Wheat flour, per barrel	4.30	10.00
Cotton, per pound	.12	1.20
Pig iron, per ton	25.00	63.00
Molasses, per gallon	.37	1.43
Lard, per pound	.11½	.23
Pork, per barrel	17.00	43.00
Butter, per pound	.20	.55
Rice, per pound	.03½	.13
Cheese, per pound	.09	.20
Wool fleece, per pound	.36	.95

From *Commercial and Financial Chronicle,* II (Jan. 6, 1866), 2-3.

[92] Mitchell, *Gold, Prices and Wages,* p. 102.

[93] Myers, *op. cit.,* p. 315.

and potential currency far exceeded the needs of business and that a rather large contraction of it could take place without harm. Early in 1866 a leading financial journal commented:

> . . . we have nine hundred millions of paper currency afloat at present, though the country has never been able in times of peace to use more than 200 millions without the most mischievous resulting inflation; and the utmost amount on which a specie basis could be kept afloat would not probably exceed the average amount of 300 millions.[94]

A part of this amount was legal-tender interest-bearing debt, much of which was privately held for investment, but all of which could serve as bank reserves, thereby enlarging the credit base and inducing speculation. Especially significant at this time and for some years after was the fact that bank reserves remained substantially above requirements. In 1868 the average country-bank reserve was 24 per cent, the minimum requirement being 15 per cent; and reserves in the fifteen redemption cities averaged 31 per cent, the minimum requirement being 25 per cent. In both types of banks the cash portion of the reserves was approximately twice the legal requirements.[95] This was an unusual condition. It was due in part perhaps to the newness of the national banking system,[96] but much more, probably, to the conservatism of bankers, businessmen, and speculators at a time when a postwar recession was widely anticipated.[97] Certainly it was an indication of the superabundance of currency.

The redundant currency and the potential credit supply in consequence of the excess of bank reserves were a continual temptation to speculative activity. If the excess currency could be withdrawn before it was to any great extent employed in such a way, the contraction would have no appreciable effect upon the rate of production. Contraction *during* the course of a speculative boom, however, would have a generalized effect of making funds scarcer and dearer both for speculation and for business. Further contraction of the currency might be expected when demand held over from the war period was filled and production was once again

[94] *Commercial and Financial Chronicle,* II (Jan. 6, 1866), 3.
[95] Myers, *op. cit.,* pp. 235-236.
[96] Cf. *ibid.,* p. 235.
[97] See, for example, *Treasury Report,* 1865, pp. 11-12; *Commercial and Financial Chronicle,* I (Sept. 16, 1865), 353; *Economist,* XXIV (April 14, 1866), 441; Sumner, *op. cit.,* p. 213; Newcomb, *op. cit.,* p. 144.

gauged to meet only current requirements of the population. Means for the expansion of capital facilities would properly be expected to come from savings and from the importation of foreign investment funds rather than through a transmutation of liquid capital into fixed capital.

TREASURY CONTROL OVER THE MONEY MARKET

Three important means by which McCulloch retained control over the money market while he continued to retire greenbacks were the maintenance of the temporary loan deposits, the maintenance of a large currency balance, and the judicious retention and sale of Treasury gold.

The temporary loan deposits, earlier described, were placed with the Treasury chiefly by the banks as a convenient, liquid investment for idle funds. In the five months of deficit immediately after the war, McCulloch had allowed these deposits to increase by $54 million to a total of $107 million.[98] Thereafter, as the debt was reduced and the short-term part of it placed in process of conversion, he permitted this part of the debt steadily to increase to $149.5 million in June, 1866.[99] Financial commentators criticized this increase in the amount of what were practically call loans to the Treasury. Each step taken to contract the currency, it was supposed, would tighten the money market somewhat, and banks would be induced to draw down these deposits with the Treasury. The greenbacks thus paid to them would thereby be returned to circulation.[100]

This policy, so widely criticized in financial circles, attests both to McCulloch's thorough comprehension of the nature and sensitivity of the money market and to his skill in managing the debt. He made no declaration with regard to the deposits except to state his anticipation that soon the need for "any kind of temporary loans" would be past.[101] Prudently he allowed the available balance in the Treasury to increase as the temporary loans increased. It was certainly not inflationary to accept freely the deposit of bank funds and hold them idle in the Treasury. The amount of them, like

[98] *Treasury Report,* 1867, p. iii.

[99] Bolles, *Financial History, 1861-1885,* p. 91 n.

[100] *Commercial and Financial Chronicle,* I (Oct. 7, 1865, 449; II, March 3, April 21, 1866), 257, 482; *Merchant's Magazine,* LIII (Nov., 1865), 235-236, LIV (March, 1866), 230.

[101] *Treasury Report,* 1865, p. 21.

the excess of banking reserves, was plain evidence of the superfluity of currency. They, too, were in a way a barometer of the money market. When the rate of interest on them was reduced from 5 to 4 per cent as of May 1, 1866,[102] the deposits continued to increase.

In this way a large amount of funds was held out of the money market, where they would have constantly tempted the bankers to put them to work. This gained time for the Secretary to carry out other parts of his program—to reduce the volume of greenbacks and redeem and convert other inflationary parts of the debt. He may have felt that under less favorable conditions opinion would turn against his general policy, as he soon saw it do, and that it was wiser to pursue the reduction of greenbacks and to eliminate that part of the short-term debt which might otherwise be continued. The payment of the temporary deposits, which general opinion held should be done first, could for that very reason be safely delayed. Moreover, these temporary loan deposits could serve as a safety valve if, through miscalculation of some unforeseen event, the pressure of contraction should more than take up the slack and cause actual stringency in the money market. In such an event, bankers could simply draw down their balances with the Treasury and restore depleted reserves. This same protection would be afforded in case speculators combined to hoard currency and thereby depress security prices.

Building up and maintaining a large currency balance in the Treasury was also a part of McCulloch's monetary policy. Eager as he was to redeem and cancel greenbacks and to reduce other parts of the debt, a large Treasury balance gave him the means to do so at the most favorable times, was a protection against the mass of short-term debt, and also served as a defense against those who might conspire to make currency scarce. In the simple procedure of purchasing government obligations in the open market the Secretary had power to increase the supply of currency and credit when it seemed to him desirable.

At the end of the war the Treasury had had difficulty maintaining a balance to meet the demands upon it, but by the end of August, 1865, Treasury cash amounted to $88 million. In June, 1866, it stood at $122 million after allowing for gold certificates

[102] *Commercial and Financial Chronicle*, II (April 21, 1866), 482.

outstanding. A year later, on the same basis, it was above $160 million, the amount of coin held exceeding that of currency. On July 1, 1868, the net balance, though reduced to $113 million, was still far more than adequate.[103]

This policy—so long as it was a continuous one—of holding a large balance of currency in the Treasury, was almost as effective a restraint on unwarranted business expansion and speculation as was retirement of greenbacks, for cash held in the Treasury was simply out of use. It, too, like the temporary loan deposits, was a gauge of the redundancy of the currency, and a safety valve should serious stringency develop in the money market. As the process of tightening up the currency supply continued, complaint was made that the large balance deprived business of much-needed money and credit, that a part of the cash should be used to reduce debt and save interest.[104] McCulloch, however, was convinced that the currency in circulation was more than sufficient for the needs of business. His broad conception of debt management held no regard for a small and temporary saving in interest at the sacrifice of one important means—important to his whole policy—by which the inflationary force of the debt was held in check:

> He [the Secretary] has regarded a steady market as of more importance to the people than the saving of a few millions of dollars in the way of interest; and observation and experience have assured him that, in order to secure this steadiness [of the business of the country] in any considerable degree, while business is conducted on a paper basis, there must be power in the Treasury to prevent successful combinations to bring about fluctuations for purely speculative purposes.[105]

It was also a part of McCulloch's policy to maintain a large gold balance in the Treasury. There was no such redundance of gold, however, as there was of currency, and for this reason the Treasury's supply of it had to be gauged carefully to the need for the metal in banking and commerce.

Although early resumption of specie payments was McCulloch's great objective, he could not attempt to accumulate gold in the way and to the extent that Sherman was later to do. He realized, of course, that a large stock of gold in the Treasury would facili-

[103] *Treasury Reports*, 1866-1868.
[104] *Merchant's Magazine*, LVI (March, 1867), 237.
[105] *Treasury Report*, 1866, p. 9.

tate resumption, but he was also aware that gold was scarce and the demand for it insistent.[106] In the years 1864 through 1868 the average yearly sale of Treasury gold was $47 million, which, because of the premium, yielded nearly $70 million in greenbacks.[107] The money-market effect of Treasury gold sales was to reduce the amount of currency in circulation. For a time after the war, the sale of gold was necessary to provide currency for the Treasury's ordinary expenditures.[108] It was necessary, too, to sell gold in order to obtain greenbacks for the purchase and redemption of the short-term and floating debt.

Nevertheless, a large balance of gold in the Treasury was deemed highly desirable by the Secretary. As an instrument of control over the money market, it supplemented the large greenback balance which he strove to maintain. The mere existence of a large gold reserve restrained speculative activity and discouraged combinations which would otherwise have sought to manipulate the markets. Timely and judicious sales of gold tended to give stability to the money market and to business generally by "preventing violent fluctuations in the convertible value of the currency."[109] Moreover, it reassured investors that the Treasury would have no difficulty in continuing to pay the interest on its bonds in gold.[110] This tended to bolster the public credit at a time when the sale of conversion bonds was of urgent importance. Again, in this instance, the loss of interest occasioned by a large gold reserve seemed to the Secretary a small price to pay for the benefits derived.[111]

In a letter replying to a House resolution[112] which asked for information on sales of gold by the Treasury, McCulloch defined his policy and explained how it was being carried out:

> It has been my purpose, either by holding or selling, to keep the market steady . . . .
>
> My instructions, given at various times to Mr. Van Dyck [the Assistant Treasurer at New York], have been to make no sales except for

[106] H. Ex. Doc. No. 124, 39th Cong., 1st Sess., pp. 1-3.
[107] H. Ex. Doc. No. 84, 40th Cong., 3d Sess., *passim*.
[108] *Treasury Report*, 1865, p. 37.
[109] *Ibid.*, 1868, pp. xlii-xliii. See also H. Ex. Doc. No. 124, 39th Cong., 1st Sess., *passim*.
[110] *Ibid.*, p. xlii.
[111] *Treasury Report*, 1868, p. xliii.
[112] *Congressional Globe*, 39th Cong., 1st Sess., May 28, 1866, p. 2857.

the purpose of supplying the treasury with currency, or for meeting the necessary demands of commerce, or preventing successful combinations either to impair the national credit or to produce serious fluctuations in prices.[113]

INCREASING OPPOSITION AND THE END OF THE CONTRACTION POLICY

As already seen, the high point of favor for the contraction policy was in December, 1865. From then on opposition to it steadily increased. There were several schools of thought with regard to contraction. Some, like McCulloch, held it to be a matter of principle, and they were also convinced that it was feasible. Many, however, who favored contraction feared that it might be carried out too rapidly or inopportunely, with serious disturbance to business and finance through the shrinking of the credit superstructure. Some were apprehensive of the power of money management in the hands of one official[114] and would have definitely limited the amount of contraction. Still others wanted no contraction whatever, and some even sought an expansion of the currency.

These last represented a movement that grew rapidly into a strong inflation party which drew to itself various classes and interests, especially those of agriculture. In the West the demand for more currency became insistent. This demand was associated with the continuing decline in the prices of agricultural commodities. The high cost of goods to farmers and the falling prices of farm products fostered a fear of currency contraction. This fear was exploited by ill-informed or ill-intentioned politicians. The contraction-inflation controversy was to a large extent sectional: the commercial East against the agricultural West. The Democratic Party became the party of the inflationists. Early in 1866 the trend

[113] H. Ex. Doc. No. 124, 39th Cong., 1st Sess., p. 2 See also statement with regard to Treasury gold sales in H. Ex. Doc. No. 134, 39th Cong., 1st Sess., p. 3.

[114] "Seldom in the history of nations has any individual statesman been entrusted with greater power in time of peace than is at this moment wielded by the Secretary of the Treasury. He can expand or contract the currency, and can thus produce results which thrill in every nerve and fibre of the body-politic. His movements touch society at all points, and for evil or for good are ever acting on the productive powers and industrial development of our people" (*Commercial and Financial Chronicle*, I, Sept. 2, 1865, 289).

"So complete and so pervading is the power wielded by the Treasury over the financial system of the country that every new order, with its probable effects and indications of future policy, is earnestly canvassed among our business men" (*ibid.*, I, Dec. 26, 1865, 770).

of thought in Congress turned more and more away from the contraction idea. Some members denounced it vigorously. Others expressed astonishment that anyone should propose taking up that part of the debt which bore no interest and replacing it with interest-bearing bonds. To them this was simply unbusinesslike.[115]

Instead of fulfilling its promises made in December, 1865, Congress, in the Act of April 12, 1866, limited the rate of currency contraction by forbidding the retirement of more than $10 million in the following six months and permitting a maximum withdrawal of $4 million in each month thereafter,[116] This was a modification rather than a reversal of policy, but it more effectively checked contraction than the actual limits set would indicate. The reason for this was that the withdrawal of the greenbacks could be prudently undertaken only at those seasons when trade was slack. In the autumn and spring, when the need for currency was greatest, the withdrawal of the legal-tender notes would have induced stringency in the money market, if not for reasons of real shortage then for psychological reasons and because of the encouragement it would give to some interests to "lock up" or hoard currency for speculative purposes. Thus it was possible to retire only a part of the amount permitted by this legislation.

McCulloch expressed his disappointment that the House resolution for contraction was "not sustained by corresponding legislation" and that he was "prevented from taking the first important step toward a return to specie payments." Late in 1866 he pointed out that during that year "the reduction of these notes and of the notes of the State banks has been nearly balanced by the increase of the circulation of the national banks; and specie commands about the same premium it did when the last treasury report was prepared."[117]

As an indication of the changing attitude toward resumption this limitation upon contraction was significant, but it did not impair confidence. In May, 1866, however, the financial panic in London associated with the Overend-Gurney failure had international reprecussions which, for a time, were felt in the American markets.[118] In some quarters blame for the resulting disruption of business was placed on McCulloch's contraction policy. But throughout the rest of the year, except in the month of November,

[115] See Noyes, *op. cit.*, pp. 11-13.
[116] 14 Statutes 31.
[117] *Treasury Report*, 1866, pp. 8-9.
[118] Noyes, *op. cit.*, pp. 14-15.

when for a brief period some stringency was felt in the loan market, currency was abundant.[119] The November stringency was attributed to the continuation of contraction and to the sale of bonds and gold by the Treasury at a time when seasonal demand for funds was at its height.[120] There was still a desire to place the currency upon a sound basis, but the wish that it might be done in some painless way led to the proposal of various schemes. In the latter part of 1866 the *Commercial and Financial Chronicle* commented that it found "the public press teeming with all kinds of visionary projects for restoring the currency without contraction."[121]

The trend against the Secretary's avowed policy of contraction continued. As has been observed, Congress, in March, 1867, in order to counteract any deflationary effect of the refunding of the legal-tender compound-interest notes, provided for the issue of 3-per-cent certificates which were eligible as a part of bank reserves, and required them to be used in the preliminary funding operations. More of these certificates were authorized in July, 1868. This move was simply a means to neutralize the effect of the earlier legislation authorizing contraction of the greenbacks.[122]

Opposition to the policy of contraction gained ground in 1867. Many people had begun to fear that a reduction in the amount of greenbacks would lead to trade recession, injury to business, and unemployment. Especially in the West, demand intensified for inflationary measures.[123] During 1867 there was some increase in speculative activity,[124] but conversion and the continued reduction of the greenbacks were restraining influences. Nevertheless, speculation absorbed some of the excess paper currency, and pressure was felt in the loan markets. There was a stock-market crisis early in 1867, some business failures occurred during the summer, and the rate on 60-day commercial paper tended to range between 8 and 10 per cent.[125] The paper circulation of the country had been reduced by $65 million during the fiscal year 1867.[126] But as the amount of currency decreased, bank loans increased. Be-

[119] Sumner, *op. cit.*, p. 212; *Commercial and Financial Chronicle*, III (Dec. 1, 1866), 676.

[120] *Ibid.* [121] III (Sept. 15, 1866), 321.

[122] Blaine, *Twenty Years of Congress*, II, 327.

[123] Hepburn, *History of Coinage and Currency*, pp. 209-210.

[124] Sumner, *op. cit.*, p. 213. [125] *Ibid.*

[126] For a discussion of the political significance of these trends, Upton, *Money in Politics*, p. 131.

tween January 1, 1866, and January 1, 1868, the loans of national banks rose by $118 million, while deposits gained only $18 million.[127]

Commodity prices were substantially lower in 1867. For a time, in order to protect the market from too rapid an accumulation of currency in the Treasury, McCulloch suspended the sale of conversion bonds for cash and disposed of them only in exchange for the 7.3-per-cent notes.[128] In the autumn the money market again became stringent. The general contraction policy of the Treasury was being felt, and the trend of sentiment against it accelerated.

The significance of the situation was heightened by the fact that until early 1868 the full impact of contraction had been cushioned by the steady expansion of the national-bank-note circulation, which had risen from $213 million on January 1, 1866, to $294 million on January 1, 1868.[129] Since this latter amount was by then close to the authorized limit, the contraction in other parts of the currency could no longer be partly offset by further increase in the amount of these notes. It was realized in the money market that if contraction continued at the same rate as theretofore, it would be even more effective in reducing the currency supply and lowering prices. That the postwar readjustment was necessarily a painful process became more and more apparent:

> At ths juncture outcries were raised against contraction by those who were engaged in the movement of expansion, though, in regular business, credit was still kept in the narrow bounds to which it had been reduced during the war . . . .[130]

> . . . the country was on the road to resumption at last, but the wrecks of fortunes threatened to strew its pathway. Congress became alarmed and determined to postpone the evils it could not avoid.[131]

Influenced by this sentiment, Congress, early in 1868, revoked the authority of the Secretary to continue contraction of the greenbacks.[132]

[127] See Sumner, *op. cit.*, pp. 212-213.

[128] *Commercial and Financial Chronicle*, V (Aug. 10, 1867), 165.

[129] For an excellent analysis of the financial developments at this time, see Sumner, *op. cit.*, p. 212.

[130] *Ibid.*, p. 213.

[131] Upton, *op. cit.*, p. 131.

[132] The Act of Feb. 4, 1868, formally suspended the retirement and cancellation of United States notes (15 Statutes 34).

This was the end of the McCulloch plan. It was the end of all serious debate upon resumption, for at least six years. It was also, and very logically, the beginning of the fiat-money party and of the plan to pay the Government's bonded debt, wherever practicable, in notes.[133]

Although a total of $450 million of greenbacks had been authorized, $50 million was required by law to be held to insure prompt payment of the temporary loan deposits made with the Treasury. By 1867, all of these deposits having been repaid, it was generally understood that the maximum greenback authorization was $400 million. This limit to the amount of greenbacks had been made clear in the Act of June 30, 1864, in which the following provision was made:

> . . . nor shall the total amount of United States notes, issued or to be issued, ever exceed four hundred millions of dollars, and such additional sum, not exceeding fifty millions of dollars, as may be temporarily required for the redemption of temporary loan.[134]

During McCulloch's term of office $44 million was retired, leaving the total outstanding at $356 million when their further retirement was prohibited.

At first, after the war, fear of a recession had inhibited speculative excesses. Then the Secretary's firmly declared policy of contraction did so. By the time further contraction was forbidden, the amount accomplished—in conjunction with the redemption and conversion of short-term debt and the policy of maintaining a large Treasury balance—had materially lessened the redundancy. When in February, 1868, Congress forbade further withdrawal of greenbacks, the action was regarded as a reversal of the conservative policy which the Secretary had furthered since the war. Whatever he might continue to do to stabilize the economy and discourage speculation became a minor consideration compared to the avowed policy of Congress which indefinitely postponed resumption of specie payments. The significance of this was soon recognized. Then gradually began that orgy of speculation to which an excessive irredeemable currency is alway conducive and which McCulloch through his policies had staved off for three years.

[133] Noyes, *op. cit.*, p. 16.

[134] 13 Statutes 218.

CHAPTER XI

Monetary Policy in Relation to Debt Management, 1869-1879

Secretary Boutwell's Greenback Policy

EVEN WITH the substantial contraction of the currency which had taken place under McCulloch, in 1869 resumption of specie payments seemed as far off as ever. Before the war the maintenance of specie payments by the Treasury had been a relatively simple matter. Then all of the Treasury's receipts and all its expenditures were in gold. When notes or bonds were at times sold to make up a deficiency in the revenues, gold was received in payment for them. There was no mass of circulating notes, such as the greenbacks, awaiting payment. Although, in the decade before the war, the balance of international payments was against the United States, this was made up for by the flow of foreign investment funds into the country and the exportation of whatever gold was necessary to complete the balance. The rich yield of the California mines provided more than enough specie for this purpose, and the stock of specie within the country steadily increased. Before the war this stock substantially exceeded the total bank-note circulation.[1]

When Secretary Boutwell assumed office, the situation was very different. Between 1864 and 1873 the high level of prices—owing in large part to the inflation of the currency—resulted in an average annual excess of imports of about $105 million.[2] Only a part of this excess could be counterbalanced by the export of gold.[3] The remainder had to be met by foreign investment in American securities.[4] The gold stock of the country had declined to a low level.

[1] See *Report of the Comptroller of the Currency*, 1919, II, 34.

[2] F. D. Graham, "International Trade under Depreciated Paper. The United States, 1862-79," *Quarterly Journal of Economics*, XXVI (Feb., 1922), 231-233.

[3] *Ibid.*

[4] ". . . by the remittance of bonds we have simply deferred payment, and

Gold receipts from customs duties were mainly disbursed as interest on the debt, most of the remainder being sold to prevent a serious shortage of the metal.[5]

The situation had changed since that brief period just after the war when Congress solemnly vowed to resume specie payments at an early date, when the nation's credit was ascendant, and when, because of these factors, gold for resumption could have been borrowed abroad. The clamor for inflation had blighted the improvement in public credit, and, even with the vast amount of debt reduction and reassurances from Congress, its revival was slow.

The years of Boutwell's administration were highly prosperous for American industry. The currency-contraction policy had been abandoned, money and credit were abundant, speculation was rife, and fortunes were made with ease by the lucky, the clever, and the rapacious.[6] By 1869 stock speculation by means of borrowed money was absorbing the redundant currency, and rates on call and short-term loans rose. There was some stringency throughout that year, but by 1870 the high money rates had attracted funds to New York from all parts of the country. Because of this fact, borrowers could provide themselves with money at between 4 and 6 per cent during most of the year.[7] As the boom developed, a large demand for funds for railroad construction arose, and much of it was met by speculative purchases of securities on borrowed money rather than from savings. Liquid assets were exchanged for long-term debt and equities; and the volume of the loans and deposits of the banks accompanied the upward course of the expansion.[8]

Intent upon the reduction and refunding of the debt, and convinced that any early attempt at resumption would be futile, Boutwell was nevertheless obliged to give considerable attention to the monetary aspects of Treasury policy, for the currency was still the great national problem. He did not share McCulloch's view

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must hereafter export products to meet these obligations" (*Report of the Special Commissioner of the Revenue,* 1869, p. xxxi).

[5] For details of Treasury gold sales, as well as the attitudes of McCulloch and Boutwell toward them, see the following: H. Ex. Doc. No. 124, 39th Cong., 1st Sess.; H. Ex. Doc. No. 134, 39th Cong., 1st Sess.; H. Rept. No. 14, 39th Cong., 2d Sess.; H. Ex. Doc. No. 84, 40th Cong., 3d Sess.

[6] Nevins, *Hamilton Fish,* chap. xxvii.

[7] Sumner, *History of American Currency,* pp. 216-217.

[8] Clement Juglar, *A Brief History of Panics,* translated and edited by DeCourcy W. Thom (3d ed.; G. P. Putnam's Sons, New York, 1916), pp. 17, 124, 127-128.

that contraction of the greenbacks could bring about an early resumption of specie payments. "The ability of the country to resume specie payments will not be due to any special legislation upon that subject, but to the condition of its industries, and to its financial relations to other countries."[9] When the credit of the United States could be established in Europe, and American exports, exclusive of evidences of borrowing, equalled imports, "specie payments may be resumed without even a temporary embarrassment to the business of the country."[10]

Boutwell believed that the country was "not prepared to sustain the policy of contraction," but that by refusing to add to the amount of paper in circulation and by allowing the "influence of existing natural causes" to take their course, "our financial condition will gradually improve."[11] These "natural causes" he perceived to be the growth of population, the increasing use of the outstanding paper money by the South and West, the "revival of our foreign commerce," the increased use of American vessels in foreign trade, greater efficiency and economy in internal transportation, and the employment of "those measures which encourage American manufacturers . . . and discourage the importation of like products."[12] Of the two—McCulloch and Boutwell—the latter was a staunch protectionist, but both were definitely mercantilistic in their views.

Boutwell, however, was not opposed to contraction as a part of a larger policy which contemplated gradual return to conditions under which resumption would be easily possible. He recognized the relationship between the state of the public credit and the oversupply of currency. In his report for 1869 he said:

> The depreciation of the currency is due to two causes—first, an excessive issue; and secondly, to the want of faith in the government; and the extent of the influence of the first-named cause cannot be ascertained until the second is removed substantially.[13]
>
> . . . . . .
>
> It is probable that some decrease in the volume of paper will ultimately be necessary, and I, therefore, respectfully suggest that the Secretary of the Treasury be clothed with authority to reduce the circulation of United States notes in an amount not exceeding two millions of dollars in any one month.[14]

[9] *Treasury Report*, 1869, p. xiii.
[10] *Ibid.*, p. xiv.
[11] *Ibid.*, 1872, p. xxii.
[12] *Ibid.*, pp. xxii-xxiv.
[13] *Ibid.*, 1869, p. xiii.
[14] *Ibid.*, pp. xv-xvi.

Although he continued to believe that the value of the depreciated currency would enhance with the development of the country, he came to stress more and more the effect that a reduction in the amount of it would have upon its value:

> All legislation . . . which in its effects shall tend to diminish the market value of coin, will be found, upon analysis, to contain a plan for contracting the volume of paper currency; and all legislation . . . which does not contain such a plan, will prove ineffectual.[15]

But since he was convinced that the people would not accept a policy of contraction, he believed that there must be "a sturdy refusal to add to the paper in circulation, until it is of the same value, substantially, as coin."[16] At the same time he urged that the greenback part of the currency be made more flexible by giving the Secretary power to increase or decrease the amount of it within certain limits. As for the national-bank-note circulation, since the banks derived a profit from it, "it can never be wise to allow banks . . . to increase or diminish the volume of the currency in the country at their pleasure." In proposing that the greenback circulation be made more flexible, he did not recognize the true flexibility which banking imparted to the deposit currency of the country. In this connection he merely stated that the increasing use of bank checks and certificates of deposit delayed the time when the growth of the country would make the greenback circulation no longer redundant and would bring its value to a parity with gold.[17]

What Boutwell believed and what he did concerning the greenbacks were quite different. In the summer of 1869 only $314 million of the $356 million outstanding actually circulated. The rest remained idle in the Treasury. By 1872 he had permitted the amount in circulation to increase to $346 million.[18] During brief stringencies in 1869 and 1871 he had also reissued $1.5 million which had been previously retired.[19] In the fall stringency of 1872, Richardson, acting for Boutwell, caused the Treasury to issue $5 million more of the canceled greenbacks.[20] Withdrawing these overissues was done with difficulty. In fact, the withdrawal of the

[15] *Ibid.*, 1872, p. xxii.
[16] *Ibid.*
[17] *Ibid.*, pp. xx-xxii.
[18] Noyes, *Forty Years*, p. 17.
[19] Shultz and Caine, *Financial Development*, p. 353n.
[20] Detractors of the administration claimed that this was done to influence the fall elections in the West (Nevins, *op. cit.*, p. 696).

$5 million issued in 1872 "kept the market stringent, and rates excessive, throughout the winter."[21] In spite of his expressed convictions as to monetary policy Boutwell simply followed the path of least resistance. In his hands the greenbacks were expansible but certainly not flexible.

Secretary Richardson and the Panic of 1873

In principle Secretary Richardson favored resumption. When he took office he believed that there was a growing desire of the people for it, and he declared that either the volume of currency must be reduced or the amount of coin increased. He shared the opinion of conservative financiers that any large augmentation of the amount of legal-tender notes would injure the government's credit, delay resumption, and constitute a breach of public faith.[22] But, like Boutwell, he did not adhere in practice to what he held to as principle. During his term of office he reissued $26 million of the greenbacks which McCulloch had retired. This was a high-handed act, of doubtful legality, for with no authority from Congress to do so he had thus increased the public debt. His belief that the country must "grow up" to resumption and that the balance of trade must turn in favor of the United States before resumption could be achieved was the same as that of his predecessor.[23] As for the possibility of early resumption, by September, 1874, both he and the President were of the opinion that it might soon be accomplished.[24]

Richardson continued Boutwell's debt-reduction policy. In his zeal to pay down the debt, however, he allowed the Treasury's currency balance to decline to a low level. During 1872 it averaged only $12.5 million.[25] All of the $43 million surplus for fiscal 1873 was used to reduce the debt, and $7 million more besides.[26] The Treasury was in an extremely poor position to come to the aid of the market when a crisis developed in September, 1873. The story of the great panic which then ensued has been recounted many times. Here its money-market aspects can be traced in a few words:

[21] Sumner, *op. cit.*, p. 218.
[22] *Treasury Report*, 1873, pp. xviii-xxi.
[23] *Ibid.*, p. xxiv.
[24] Nevins, *op. cit.*, p. 702.
[25] Kinley, *Independent Treasury*, pp. 181-182.
[26] *Commercial and Financial Chronicle*, XVII (Dec., 6, 1873), 749.

In 1873, the farmers' movement against the railroads impaired confidence in railroad bonds as an investment. When the crop movement began again the demand of the country banks led to a demand from the city banks upon the brokers, and precipitated a panic on the stock exchange. The failure of several large banking houses engaged in the sale of railroad bonds increased the excitement. The closing of the stock exchange, and suspension of the city banks, obliged the country banks to contract their loans, and brought the industry of the country to a standstill.[27]

A great superstructure of credit had been raised upon the basis of a paper currency issued in excess of the true needs of industry and commerce. The use of much of that credit, rather than of savings, for the construction of capital goods, reached its furthest limit when the money reserves behind it could support no more. What were by their nature short-term funds had been engaged to acquire long-term debt and slowly developing equities. When the money reserves of the banks were thus fully employed, the added demand upon them from the interior of the country for funds to harvest and move the crops brought a day of reckoning the inevitability of which had been obscured by the artificial liquidity of the stock and bond markets. The Treasury was not prepared for this eventuality and was powerless to help. Even if it had been able, and had its action been effective, the long-delayed readjustment which followed the panic would have been merely postponed.

The panic began on September 18. Within less than a week the Secretary had expended a large part of the Treasury balance in purchasing government obligations:

> Purchases of bonds were commenced on the morning of the 20th of September, and were continued until the 24th, when it became evident that the amount offering for purchase was increasing to an extent beyond the power of the Treasury to accept, and the purchasing was closed after bonds to the amount of about thirteen million dollars had been bought, and without the use of any part of the forty-four millions of United States notes, generally known as the reserve.[28]

These purchases in the open market did nothing to stay the crisis. The public knew the limit of the Treasury's resources, and so no confidence was aroused by the Secretary's great willingness to do all that he possibly could. At such a crisis in England the

[27] Sumner, *op. cit.*, p. 218.

[28] *Treasury Report*, 1873, p. xv.

Bank Act would have been suspended, thereby permitting the Bank of England to supply an unlimited amount of funds to all who presented good collateral. There just the fact that this could be done was often sufficient to allay the fear that breeds panic.[29] But no comparable means existed in the United States. The use of clearinghouse certificates was a palliative but not a substitute for the protection and elasticity which a wisely empowered government bank or central bank might have provided.

The intense excitement and financial distress prompted all kinds of suggestions and demands as to what the Treasury should do to end the devastation and ruin which was taking place. The Secretary was urged to buy foreign exchange or lend against it, to prepay bonds not yet matured, to issue more United States notes.[30] This last expedient Richardson proceeded to follow. Greenbacks were taken from the so-called "reserve" and used both to purchase bonds and to meet current expenses of the Treasury.[31]

A favorable consequence of the panic was the change in the balance of international payments which occurred late in 1873. As a result of the drastic decline in prices and the diminished buying power of the people, exports increased and imports decreased greatly.[32] The outflow of gold fell below the amount being produced within the country.[33] For the fiscal year 1874 exports exceeded imports by $18.9 million.[34] For 1875 imports were greater by $19.6 million.[35] Thereafter, there was an excess of exports which increased, gradually at first, then rapidly, until, in each of the fiscal years 1878 and 1879, it exceeded $250 million.[36] This development did not result in the shipment of an equal amount of gold to the United States, for a considerable part of the balance was offset by book-credit adjustments and the return flow of government securities. Nevertheless, the two essential conditions for resumption had been fulfilled: prices were low and the balance of trade was favorable. It was five years, however, before resumption could take place, for another consequence of the panic and ensuing depres-

[29] Adams, *Public Debts*, pp. 215-216. [30] *Treasury Report*, 1873, *passim*.

[31] Hepburn, *History of Coinage and Currency*, p. 221; Barrett, *The Greenbacks*, p. 176; Adams, *Public Debts*, pp. 215-216; *Commercial and Financial Chronicle*, XVII (Dec. 6, 1873), 749.

[32] *Treasury Report*, 1873, p. xxiii.

[33] *Ibid.*, 1874, pp. xxi-xxii; and H. Misc. Doc., No. 606, 50th Cong., 1st Sess., Appendix D.

[34] *Treasury Report*, 1875, p. xxxvii. [35] *Ibid.*

[36] *Ibid.*, 1878, p. xxxi; 1879, p. xxix.

sion was a widespread revival and intensification of inflation sentiment.

Veto of the Inflation Bill

Following the panic, enormous pressure was brought upon Congress to give relief to business interests and to the people in general. Many wild financial schemes were proposed, and there was widespread demand for an increase in the amount of the greenbacks. "More than sixty bills, resolutions and propositions were introduced in the Senate in respect to the currency, the public debt and national banks, all bearing upon the financial condition of the country."[37]

The proponents of an abundant currency differed among themselves as to the most suitable form of it. Most of them agreed, however, that the national-banking system should be done away with and that one form of currency should be issued directly by the government.[38] Some advocated simply an increase in the amount of greenbacks, with their payment in specie postponed indefinitely. Others wanted printing-press money with no particular limit to the amount. Another school of thought urged the use of irredeemable legal-tender notes made exchangeable for 3.65-per-cent bonds, the bonds to be exchangeable for such notes and the interest on the bonds to be paid with the same kind of notes. This last method, which Garfield called a form of "financial perpetual-motion," received much earnest but unenlightened consideration.[39]

After several months of consideration, the Senate Finance Committee decided upon a measure fixing the maximum amount of the greenbacks at $382 million, the amount then outstanding. It also provided for their gradual redemption either in coin or in 5-per-cent bonds, at the option of the Secretary of the Treasury.[40]

[37] Sherman, *Recollections,* I, 490.

[38] At a hearing before the House Committee on Banking and Currency on two bills which proposed to substitute United States notes for the approximately $350 million of national-bank notes then outstanding, twenty-five monetary and financial authorities testified. It was the conclusion of the committee that such a substitution "would require either an increase of the public debt to that amount, or a withdrawal of bonds, to be replaced by United States notes. It is not perceived how the Treasury would be benefited by an increase of the public debt, and it is not believed that our interest-bearing bonds could be exchanged for an additional issue of United States notes except at a great disadvantage in the transaction itself and to the serious detriment of the public credit" (*H. Rept.* No. 328, 43d Cong., 2d Sess.).

[39] James A. Garfield, "The Currency Conflict," *Atlantic Monthly,* XXXVII (Feb., 1876), 219-223.

[40] Sherman, *op. cit.,* I, 495.

The correct legal limit to the amount of these notes was a matter of controversy. Senator Sherman clearly presented the issues involved in determining upon a legal maximum. He said:

On the one hand it is insisted by Senators who compose the majority of the Committee on Finance that the legal limit of United States notes is $356,000,000, that the amount which has been already issued of what is known as the $44,000,000 reserve was unlawfully issued, although under great press of circumstances and without any intention on the part of the Secretary to do more than he thought he had a lawful right to do. On the other hand it is insisted by other Senators that the legal limit of United States notes is $400,000,000; and here is a margin of $44 million upon which there is a dispute of law as to the power of the Secretary to issue it. That dispute ought to be settled at once. It is a question that ought not to be in doubt a moment, because the power to issue that $44 million places it in the discretion of the Secretary of the Treasury either to advance or to lower the value of all property in the United States, of all debts in the United States, of everything that is measured by United States notes.[41]

This bill, after it was reported by the committee, was so radically amended in the Senate that its nature and purpose were completely changed. The maximum of greenbacks was set at $400 million, $18 million more than that established by Richardson's reissue of $26 million. In addition to providing this permanent increase in the circulation, it authorized $46 million more in national-bank-note circulation, which would have raised the total of that currency also to $400 million. The measure, very appropriately, came to be called the "inflation bill." "Instead of a return to specie payments, it provided for an expansion of an irredeemable currency."[42] In this form it readily passed both the Senate and the House. President Grant, though not sharing the extreme views of the inflationists, had encouraged them to suppose that he would countenance an increase in the currency. In his annual message of December 1, 1873, he had said:

In view of the great actual contraction that has taken place in the currency and the comparative contraction continuously going on, due to the increase of population, increase of manufactories and all the industries, I do not believe there is too much of it now for the dullest period of the year.[43]

[41] *Congressional Record*, 43d Cong., 1st Sess., March 24, 1874, pp. 2386-2387.
[42] Sherman, *op. cit.*, I, 504.
[43] Richardson, *Messages and Papers of the Presidents*, VII, 245.

When, at a Cabinet meeting, he told of his first inclination to sign the bill and his more mature decision to veto it, "The Cabinet inflationists sat stunned as Grant announced this *volte-face*."[44] There was not a sufficient majority in Congress to override the veto.

Grant's indecision in matters of the currency mirrored that of the people at large. His final determination to veto the inflation bill was reached after studious reflection in which he had first sought to justify his approval of it.[45] An able general, now President, took the more difficult course and courageously reversed himself. The amount and quality of the nation's currency, the prospect of its eventual payment in gold for which it was a promise, the value of the dollar at home and abroad, and the state of the public credit, all depended upon the decision of this one man who, at this juncture, had studied the problem, applied careful reasoning, and reached a decision contrary to his more immediate personal interest. Thus, during the most scandalous administration in American history, there appeared that rare trinity of virtues which must characterize money-managers—probity, wisdom, and courage.

The Resumption Act

A part of the support for the inflation bill had come from Republicans who had seen in it a last desperate chance to find favor with a depression-ridden population intent on throwing out the administration in power. Overwhelmingly defeated in November, 1874, those members of Congress cannily determined that there was "nothing to risk by a move in sound-money legislation, and possibly much to gain."[46] The result was the Resumption Act of January 14, 1875.

The debate and compromise with regard to the resumption bill took place in the Senate Finance Committee rather than on the floor of either the Senate or the House. The bill was reported to the Senate on December 21, 1874, and was only briefly debated, passing without amendment by a vote of 32 to 14. On January 7, 1875, after brief discussion, it passed the House by a vote of 136 to 98. On January 14, the President's message heartily approving the bill was sent to the Senate.[47]

[44] Diary of Hamilton Fish, April 21, 1874, quoted in Nevins, *op. cit.*, p. 712.
[45] *Ibid.*, p. 712.
[46] Noyes, *op. cit.*, pp. 20-21.
[47] Sherman, *op. cit.*, I, 507-518.

The first two sections of this enactment provided for the replacement of fractional currency by fractional silver and repealed the mint charge for coinage of gold bullion. A part of the third section removed the limit on the amount of national-bank notes which might be issued. The Secretary of the Treasury was required to redeem United States notes equal to 80 per cent of the amount of the additional national-bank notes issued under this provision until $300 million of them were outstanding. The object here was to substitute national-bank currency for a part of the greenbacks. The remainder of the act set January 1, 1879, as the date when "the Treasury shall redeem in coin the United States legal-tender notes then outstanding"; it gave the Secretary of the Treasury authority to use for resumption purposes any unappropriated surplus revenues; and it permitted the sale for resumption purposes of any of the bonds authorized by the Refunding Act.

During the preparation of this legislation in committee, one almost insuperable disagreement arose. This had to do with the meaning of the term "redeem" in the above-quoted phrase. Sherman's words best describe this impasse and the way in which it was circumvented:

> The most serious dispute was upon the question whether United States notes presented for redemption and redeemed could be reissued. On the one side it was urged that, being redeemed, they could not be reissued without an express provision of law. The inflationists . . . refused to vote for the bill if any such provision was inserted, while those who favored coin payments were equally positive that they would vote for no bill that permitted notes once redeemed to be reissued. This appeared to be the rock upon which the party in power was to split. I had no doubt under existing law, without any further provision, but that United States notes could be reissued. It was finally agreed that no mention should be made by me for or against the reissue of notes, and that I must not commit either side in presenting the bill.[48]

Preparation for Resumption and the Forces Opposed to It

How the provisions of the Resumption Act for a return to specie payments might be implemented remained a question for some time. In the first two years following passage of the act, nothing was done to prepare for the critical day. Secretaries Bristow and

[48] Sherman, *op. cit.*, I, 510.

Morrill both wanted changes in the law before attacking the problem.

Secretary Bristow urged Congress to abolish the legal-tender quality of the greenbacks and to make this change effective well in advance of the resumption date. He suggested that a very long-term bond issue be authorized into which the greenbacks might be converted and that the Secretary be given authority to redeem and cancel $2 million of the notes a month. He pointed out that

> Only the excess of notes above the needs of business would seek such conversion. . . . The present abundance and cheapness of both currency and capital presents a favorable opportunity for the withdrawal and redemption of a considerable part of the outstanding legal-tender notes, thereby making easy and effectual the redemption now pledged.[49]

Like Bristow, Secretary Morrill believed that the provisions of the Resumption Act were inadequate. He suggested that Congress empower the Secretary to fund the notes into long-term bonds. He also proposed that, as "the volume of currency is largely in excess of the real demands of legitimate business," some of the greenbacks might be withdrawn from circulation. He did not favor any attempt to accumulate gold in a sufficient amount to meet what he believed might be a large demand for it, and he held, besides, that "to accumulate [gold] in advance of that time would be attended with necessary loss of interest, would be likely to disturb money exchange, and embarrass the funding of our national securities."[50]

Almost all the financial preparations for resumption, as well as a large part of the refunding operations, were accomplished during Secretary Sherman's term of office. He handled both projects with skill and finesse. His long experience and knowledge in matters of public finance, acquired in the House and Senate, stood him in good stead when he succeeded to the secretaryship. There the vacillations which had sometimes characterized his actions in Congress were replaced by a firm and determined policy which was fortified and furthered by his skill in negotiation and his zeal to obtain every possible advantage for the government in disposing of its obligations. When he assumed office in March, 1877, he was sufficiently optimistic to believe that a surplus of revenues might permit the accumulation of gold with only a limited sale

[49] *Treasury Report,* 1875, pp. xix-xx.
[50] *Ibid.,* 1876, pp. xii, xv. xvii, xviii.

of bonds for gold being necessary. His policy was to continue the refunding operations and at the same time, by means of both bond sales and surplus revenues, gradually to accumulate a reserve of specie.[51]

The sale of the 4½-per-cent loan which had been negotiated with the syndicate by Secretary Morrill in August, 1876, was limited by Sherman to a total of $200 million, of which, by agreement, $15 million provided gold for resumption purposes. In the spring of 1877 conditions in the money market had become so favorable that 4-per-cent bonds could then be offered. Of the $75 million worth sold during the summer, $25 million was for resumption.[52]

At this point, however, the progress being made in preparation for resumption as well as in refunding the debt was suddenly halted by a resurgence of inflationism in Congress. The inflationists again marshaled their forces, this time to attempt repeal of the Resumption Act and remonetize silver. Agitation for such measures so disturbed confidence that for many months no more bonds could be sold, and their market price fell somewhat below par.[53]

The cause of the silver advocates was fortified by the findings and conclusions of the Monetary Commission of 1876. The majority of the commission held that resumption was not possible as long as gold was the "sole metallic legal-tender" and that the double standard with unrestricted coinage should be adopted. One minority opinion proposed that the co-operation of other nations be sought before silver was remonetized in the United States. Another minority pointed out that in recent years there had been "no lack, but rather a superabundance, of money"; that since 1869 the government had disposed of more surplus gold than "was necessary to redeem all the legal-tender notes outstanding." In view of this, it raised the question, "how can it be said that Congress has kept its solemnly-pledged word that it would redeem those notes 'at the earliest practicable period'?"[54]

[51] *Specie Resumption and Refunding of National Debt;* Letter of Sherman to Messrs. N. M. Rothschild & Sons, April 6, 1877, pp. 14-15.

[52] *Treasury Report,* 1877, pp. viii-ix.

[53] *Specie Resumption and Refunding of National Debt,* pp. 181-219; *Treasury Report,* 1877, p. ix; Sherman, *op. cit.,* I, 576-83; Noyes, *op. cit.,* pp. 33-35.

[54] U. S. Monetary Commission, *Report and Accompanying Documents of the United States Monetary Commission Organized under Joint Resolution of August 15, 1876* (Washington: Government Printing Office, 1877), I, 127, 138, 156, 158.

In December, 1877, President Hayes, in his first annual message, clearly presented the issues which the movement for free coinage of silver raised with respect to the currency, the debt, and the public credit:[55]

If the United States Government were free from a public debt, its legislative dealing with the question of silver coinage would be purely sovereign and governmental . . . . But in the actual circumstances of the nation, with a vast public debt distributed very widely among our own citizens and held in great amounts also abroad, the nature of the silver-coinage measure [the Bland bill], as affecting this relation of the Government to the holders of the public debt, becomes an element, in any proposed legislation, of the highest concern. The obligation of the public faith transcends all questions of profit or public advantage otherwise.

. . . . . .

If the United States had the unquestioned right to pay its bonds in silver coin, the little benefit from that process would be greatly overbalanced by the injurious effect of such payment if made or proposed against the honest convictions of the public creditors.

. . . . . .

To require the public creditors to take in repayment any dollar of less commercial value would be regarded by them as a repudiation of the full obligation assumed.

. . . . . .

Any attempt to pay the national indebtedness in a coinage of less commercial value than the money of the world would involve a violation of the public faith and work irreparable injury to the public credit.

A few months later Secretary Sherman had the opportunity to defend the Resumption Act against its threatened repeal in a way that was both emphatic and effective. He appeared before several Congressional committees and showed in detail the feasibility of resumption, thus overcoming much skepticism and gaining favor for his plan.[56] When questioned before the Senate Finance Committee, he declared that to repeal the act "would be an evidence of national weakness," that the act was "a declaration of public policy, commenced with the act of February, 1862, repeated by Congress several times, notably in 1866, notably again in 1869,

[55] Richardson, *Messages and Papers of the Presidents,* VII, 462-463.
[56] Sherman, *op. cit.,* II, 629-635.

and again by the passage of the resumption act," and that "it ought to be adhered to."[57]

This was sound opinion, and from so experienced and respected an official it carried weight. But Sherman, intent upon resumption and pressing the advantage of being heard, shrewdly drew to its support those who cared more for the remonetization of silver than the repeal of the Resumption Act. In the course of the interview he asserted:

> Resumption can be maintained more easily upon a double standard than upon a single standard . . . . I think it can be maintained better upon a bi-metallic, or alternative standard, than upon a single one, and with less accumulation of gold. In this way remonetization of silver would rather aid resumption.[58]

It was another example of Sherman's compromise tactics, wherein he sought to further one great objective at the expense of another.

A short time later, however, he explained to another Congressional committee that his position on the matter had been misunderstood by the press and that he wished to make clear his belief that if the silver bill made the government's bonds payable in that metal it was not good policy.[59] In fact, he was then unable to sell bonds either in Europe or at home because of this pending legislation:

> The reason why I cannot sell bonds, is because they have got the impression in Europe that this silver bill is going to derange matters, and that belief brought back upon us (as these gentlemen say) seventy-five millions of bonds. As a matter of course, they came into competition with the Secretary in selling bonds; and as long as they had their bonds to sell, under a scaring market, I could not sell bonds unless the rate of interest was raised.[60]

The silver question had been temporarily settled in February, 1878, by the compromise provisions of the Bland-Allison Act, whereby free coinage of silver was prevented. In April Sherman

[57] U. S. Senate, Committee on Finance, *Interview of the Committee on Finance with the Hon. John Sherman, Secretary of the Treasury in Regard to the Repeal of the Resumption Act,* March 19, 1878 (Washington: Government Printing Office, 1878), p. 3.

[58] *Ibid.*, p. 9.

[59] H. Misc. Doc. No. 48, 45th Cong., 2d Sess., p. 8.

[60] *Ibid.*, p. 11.

again undertook to sell bonds for resumption purposes. A year before he had resolved to sell no more of the 4½-per-cent issue, but the uncertain money market and the conservative attitude of the bankers convinced him that the 4½ per cents must again be offered to place "resumption beyond peradventure."[61]

On April 11, 1878, a contract was made with the same banking syndicate which had been parties to the contract of June 9, 1877, whereby the popular sale of 4's had been negotiated. This contract provided for the sale of $50 million of 4½-per-cent bonds for resumption purposes.[62] Sold at 101½, less one-half-of-one-per-cent commission, they yielded the Treasury $50,500,000 in gold coin. The $5,500,000 paid in the Halifax award was recovered by the sale of an equivalent amount of 4 per cents for resumption purposes.[63]

It will be recalled that one provision of the Resumption Act had required a reduction in the amount of the greenbacks as additional national-bank notes were issued until the total of greenbacks was reduced to $300 million. This was a definite aid in preparing for resumption, for the smaller the amount of greenbacks the less gold would be necessary to insure their payment. This provision was rescinded, however, by the Act of May 31, 1878, when Congress forbade retirement of any more of the notes after that date.[64] This action fixed the amount in circulation at $346,681,016. "Upon the principle of safety upon which the Department was acting, that forty per cent. of coin was the smallest reserve upon which resumption could prudently be commenced, it became necessary to increase the coin reserve to $138,000,000."[65]

The year 1878 was not a prosperous one, although the balance of trade in favor of the United States was very large. It was a transition period between the great depression and the return of prosperity. In many fields of business the point of deepest depression was not passed until late in 1878. The number of business failures during the year was greater than in any previous year.[66]

[61] *Specie Resumption and Refunding of National Debt:* letters of Sherman to Fahnstock, April 16, 1877, p. 20, and March 25, 1878, p. 286; letter to President Hayes, April 9, 1878, p. 293. For details of the negotiations and the final contract, see pp. 288-296.

[62] *Ibid.*, pp. 288-296.

[63] *Treasury Report,* 1878, p. ix.

[64] 20 Statutes 87.

[65] *Treasury Report,* 1878, p. ix. See also letter to the President of the Senate, May 17, 1879, *Specie Resumption and Refunding of National Debt,* pp. 702-703.

[66] Grosvenor, *American Securities,* pp. 68-69.

In the spring the securities markets had advanced as confidence in the achievement of resumption grew. In the autumn, just when success of the resumption preparations seemed assured, the market was disturbed by peculiar and contradictory orders issued from the Treasury with regard to the disbursement of silver and the redemption of greenbacks, so that some persons were inclined to suspect that the Secretary might attempt to resume with silver rather than gold. Apprehension increased in October when orders were given for the transfer of gold held by the banks for the Treasury to the Treasury's own vaults. A strong market reaction set in, and for a brief time the probability of successful resumption was threatened. Sherman, perceiving the danger, hastened to offer gold in exchange for bonds to any amount. This ended the stringency, and the price of gold, which had begun to rise, again declined.[67]

Conditions were now propitious for resumption. In November a new Congress more favorable to it was elected.[68] By the latter part of that month the sums obtained through the sale of resumption bonds, together with the surplus revenues, brought the total of coin in the Treasury, in excess of coin liabilities, to nearly $142 million.[69] Heavy interest payments on January 1, 1879, reduced this amount somewhat, but on that date the reserve for resumption was more than $133 million.[70] "Actual resumption commenced at the time fixed by law, without any material demand for coin and without disturbance to public or private business."[71]

The Inflationary Effects of Debt and Monetary Policy

In concluding this survey of the interrelationship of monetary policy and debt management, the effect of the combined policies upon the money supply and the price level may now be summarized.

Under McCulloch, during the preliminary funding of the debt, inflation was restrained and too rapid deflation avoided. This was the result of a deliberately planned policy firmly carried out by making use of almost every device which the Treasury could employ. The failure to borrow abroad after the war lost the opportunity then to resume specie payments and thereby quickly restore the economy to a normal condition. The policy of contraction did not go far enough and last long enough to achieve

[67] *Ibid.*, pp. 101-102.
[68] *Ibid.*, p. 103.
[69] *Treasury Report*, 1878, p. ix.
[70] *Ibid.*, 1879, p. ix.
[71] *Ibid.*

this same goal. While it continued, however, its effect was to restrain speculation, hold business and finance to a conservative outlook, and keep idle the large excess reserves in the banking system. These reservoirs, under a less strict Treasury policy, would soon have been multiplied in terms of deposit currency to swell the money supply and raise prices.

At the same time, the contraction policy was made sufficiently flexible, when circumstances required, to prevent too harsh an impact on the markets. McCulloch maintained a careful control over the money supply. As his policies became known and understood, they had a double effect upon conditions. They tended to prevent stringency and panic as well as to restrain inflation. It was known that he was determined to decrease the amount of money in circulation, but it was also soon understood that he was ready to come promptly to the aid of the markets when need arose. Just the expectation of this aid made for stability. In his conversion operations he took care to prevent too much money from accumulating as bonds were sold. Interest payments and debt reduction placed funds in the market, but the effect of this was offset when necessary by contraction. The relative stability thus achieved enabled him to fund the debt rapidly. The resulting improvement in the public credit strengthened business confidence.

The policy of depositing very little of the Treasury's funds with the national banks supported contraction so far as it diminished the amount of currency available to the public. Maintaining large Treasury balances of currency and gold not only held excess currency out of use but permitted the Secretary either to draw in currency by the sale of gold or to disburse it in the purchase of government obligations. Controlling the flow of funds through the Treasury was a temporary way of restraining inflation, while funding of the legal-tender part of the debt was intended to effect a permanent reduction in the circulation.

After McCulloch's term of office, the problems of the debt and the money supply were both less acute, for the debt had been funded and a substantial amount of currency had been withdrawn. During Boutwell's administration there was an increase in the amount of greenbacks in circulation and an expansion of deposit currency for which these legal-tender notes served as a base. The policy of refunding the debt contributed to business optimism in

the years before the panic. Expenditures for debt reduction and the periodic disbursement of interest continued to make funds available for new investment and as purchasing power generally. The weak monetary policies of Boutwell and Richardson encouraged overexpansion and speculation. Bank reserves declined steadily as deposits increased, and prices and property values rose.

The slack in the money and credit supply was being taken up not by a policy of contraction but by an unwholesome overextension of business commitments. This situation was encouraged by the willingness with which the secretaries permitted the greenback circulation to expand to its legal limit and even beyond. The policy of keeping the Treasury balance at a comparatively low level as debt redemption was speeded also contributed to the inflation.

For some time after the panic of 1873 the volume of debt reduction was small and had little effect on the money market, for there was a plethora of funds. The institution of free bank currency was followed by a decline in bank-note circulation. Yet proposals to increase the currency, pay the debt with greenbacks, and monetize silver were made on all sides. The serious consideration given these demands delayed the revival of business confidence and endangered the prospect of a return to a specie basis for the currency.

So long as there was no firm policy by which the volume of the currency was adjusted to the needs of business, its fluctuating value considerably increased business risk, especially with regard to future commitments. The uncertainty resulting from a poor currency policy, or the lack of any real policy, thus added to the cost of transacting business, which in turn increased the prices of goods. Not only was purchasing power reduced by this higher cost, but the country was placed at a disadvantage in exchanging its products for those of other nations. Finally, the achievement of resumption and the completion of the refunding program, the latter at a great saving of interest, returned the economy to a sounder basis.

It should be observed that during the greenback period the economic effects of a policy which failed to prevent wide fluctuations in the value of the currency were highly complex. Prices were generally higher because of the uncertainty and also because of the depreciation of the currency, but the changing value of the

greenbacks in terms of goods and services also reflected an involved pattern of opposing forces and interests. The varying prices of goods "were the adjustments which men using prices as the basis of their economic relations were constrained to make by circumstances beyond their control."[72] Different economic classes were affected in different ways by changing prices, and they in turn influenced other price changes. Professor Mitchell says of the data acquired in his extensive study of this subject that they were "in all cases . . . the resultants of complex sets of opposing forces."[73]

The volume of currency alone did not determine the level of prices. The superstructure of credit which it permitted, as well as the rapidity of turnover of both currency and private instruments of credit, was more significant. The scarcity or abundance of goods and their cost of production were also price-making forces. Influencing all these factors was the attitude of the people. Their decisions to make effective the purchasing power at their disposal, to use or not to use the money and credit available to them, determined the force of demand. Underlying this was the collective expectation of what the future might hold. Whether simply to protect their interests or in the hope of gain, the actions of the people expressed their view of future prospects and thus influenced prices. Anticipation of continuing inflation can be enough to continue an inflationary expansion of business and rise in prices. The psychological influence of a sound and determined monetary policy throughout the greenback period would have been highly beneficial to the whole economy.

The effects of debt management and monetary policy upon the formation and flow of capital funds and upon the production, distribution, and consumption of wealth are dealt with in the following chapter.

[72] Mitchell, *Gold, Prices, and Wages,* p. 281.
[73] *Ibid.,* p. 282.

CHAPTER XII

The Effect of Debt-Management Policies on Capital Funds

It has been seen how debt management as an expression of monetary policy influenced the currency supply and the short-term use of credit, and how, through these, the price level, the cost of production, and the purchasing power of money were affected. At least as important were the effects of debt policy upon the price of gold and upon the domestic and international flow of capital funds. Perhaps most significant of all, at the time as well as for the future, was the effect of the debt, in conjunction with taxation, upon the accumulation and distribution of wealth.

Effect on the Investment Market

Debt policy affected the investment market through its influence upon the public credit, the currency supply, the amount of debt, and the distribution of debt. Although the government-bond market was a large part of the whole investment market, the securities of private enterprise were increasing rapidly in volume and importance while the available amount of government securities steadily dwindled.

The prices of stocks and bonds and the yield on commercial paper immediately reflected changes in the money supply. Just as the excessive issuance of paper money during the war had provided the people with the means to buy government obligations, so, after the war, the abundant supply of currency supported security prices. If contraction had been carried on at a rapid rate, it would quickly have lowered these prices, but the careful withdrawal of idle currency only did not put pressure on the bond market. After contraction, and until the end of the greenback period, the excessive currency continued to sustain government-bond prices, in terms of greenbacks, at a high level. Until the panic, the market for corporate securities was likewise supported.

More important, however, was the effect of debt and currency policies upon the real value of securities in terms of gold. So far as market judgment weighed the seriousness of the various proposals to pay the debt in greenbacks or in silver, or to effect repudiation in some other way, the prices of all American bonds declined in foreign markets. The continual undercurrent of repudiation sentiment throughout the postwar period kept the gold prices of securities at an abnormally low level and retarded their improvement even when all other circumstances were extremely favorable for higher prices and lower interest rates.

Refunding had no appreciable direct effect on the investment market. In essence it was the exchange of bonds of one class for bonds of another. Although the process by which it was accomplished involved the receipt and payment of large sums as new bonds were sold and older ones were called in and paid, the policy of leaving the subscription payments on deposit with the national banks prevented the funds from being tied up in the Treasury with consequent adverse effect upon the markets. Indirectly, through the enhancement of the public credit, the effect of refunding was usually favorable marketwise, although when too rapid a decline in the gold premium accompanied a successful refunding operation, security prices expressed in greenbacks were depressed.

The constant reduction of the debt was a powerful support to the whole investment market, for as it reduced the supply of government bonds, it also released funds from the Treasury to be reinvested largely in the securities of private enterprise. Debt reduction was thus continually a means for returning to circulation money drawn into the Treasury either as surplus revenue or as receipts from the sale of Treasury gold.

The wartime and immediate postwar bond-selling campaigns had resulted in a wide distribution of government debt, but after that time the ownership of the debt became more and more concentrated. Sherman's attempt to popularize the government's securities met with only partial and temporary success. Nevertheless, these efforts to make a wider market, and also the continuous public discussion of matters pertaining to the debt, acquainted people with the nature and desirability of such intangible property. Certainly the development of the corporate form of enterprise and the enormous expansion of the domestic capital market were facil-

itated as new enterprise was able to draw upon many small and large savings accumulations.

The combined effect of the resumption of specie payments and the completion of refunding restored confidence throughout the country. As a result, an unprecedented wave of investment buying set in which in the course of the following several years raised the prices of all types of securities to high levels.

Effect on the Price of Gold

The debt policies and currency policies of the Treasury continually exercised an influence on the price of gold. So long as these policies permitted an excess of currency, a high price level, and an adverse balance of trade, the resulting scarcity of gold enhanced its value. In general, policies which depreciated the credit of the country sustained the premium on gold.

Between May, 1865, and September, 1869, no permanent reduction in the price of gold took place, but in this period it was much lower and fluctuated less widely than it had during the war.[1] What the contraction policy did to enhance the public credit was largely counterbalanced by the growing demand for inflation. At the same time that the currency circulation was being reduced, the Treasury was accumulating a large stock of gold. This withdrawal from the market tended to offset the effect that contraction alone would have had upon the gold premium. Sales of Treasury gold were made from time to time in order to keep the price from rising unduly. These sales gave stability to the market, but at a higher level than would have prevailed if less of the metal had been held in the Treasury. Even with the abandonment of greenback contraction, however, McCulloch's control over the markets remained such that a rise in the gold premium was checked. During this period the "normal" price of gold was about 135 to 140.[2]

Under Boutwell's vigorous policy of debt reduction, large quantities of Treasury gold were sold at fairly regular intervals. During the first nine months of this program, the average price received for it was 132.[3] Because he was determined not to give aid to speculators in securities and gold,[4] it was possible for the great

[1] Mitchell, *Gold, Prices, and Wages*, pp. 13-14.
[2] *Ibid.*
[3] *Treasury Report*, 1869, pp. xii-xiii.
[4] Boutwell, *Reminiscences*, II, 168.

gold conspiracy which resulted in the Black Friday panic to take place. The rapid rise in the gold premium as a "corner" was threatened, disrupted all markets, and unsettled business.

After this episode, the price of gold declined. At the beginning of Boutwell's administration it had been about 140, at the end it was close to 112.[5] This was due not only to the debt-reduction policy but also to the general improvement in the government's credit following assurance given by Congress in the Public Credit Act of 1869 that the debt would not be repudiated. The refunding operations also contributed to general confidence.[6] The panic of 1873 resulted in a sharp drop in the price of gold, for the substantial increase in the amount of greenbacks at that time was of less significance than the prospect of a favorable balance of trade.

The passage of the Resumption Act in 1875, continual progress each year in refunding and reducing the debt, and finally the determination of Secretary Sherman to acquire gold for resumption, resulted in a continuous decline in the price of the metal until in December, 1878, it reached a parity with the greenbacks.

Effect on the International Balance of Payments

THE FLOW OF GOVERNMENT SECURITIES TO EUROPE AND THEIR RETURN

Largely as a result of an inflationary debt policy which made the American market the best in which to sell for Europeans and the poorest in which to buy, there was continually an adverse balance of trade from 1861 through most of 1873. From the end of the war to the year of the panic the annual excess of imports averaged around $105 million.[7] The resulting exportation of gold reduced the supply. As a consequence, it was necessary to send American securities to foreign financial centers to supplement gold in meeting the balance. This exportation of securities—both public and private—took place on a large scale. At a few times the return of these securities was in sufficient volume to have a significant influence on the money market. As the amount of debt held in Europe increased, the payment of interest upon it augmented the adverse balance of payments.

In 1866 it was estimated that the amount of American securities held in Europe was as follows:[8]

[5] *Ibid.*, p. 138.
[6] Mitchell, *op. cit.*, p. 14.
[7] Graham, "International Trade," p. 232.
[8] *Treasury Report*, 1866, p. 12.

United States bonds	$350,000,000
State and municipal bonds	150,000,000
Railroad and other stocks and bonds	100,000,000
Total	$600,000,000

The rapid increase is indicated by an estimate made three years later:[9]

United States securities	$1,000,000,000
State securities	100,000,000
Corporate and miscellaneous securities	365,500,000
Total	$1,465,500,000

The fact that a large part of the debt held abroad was in the hands of speculators—a condition to be expected as a consequence of the low state of the public credit—gave rise to some apprehension that large amounts of it might be thrown upon the American market at any time.[10] It was feared that if conditions became unfavorable, holders would be inclined to cut their losses, or, being on margin, would be obliged to sell. As the public credit improved and bonds rose in price, profit-taking on speculative holdings was expecting to retard the improvement and possibly drain gold from the New York money market.

An unfortunate aspect of this flow of United States obligations to Europe for some years after the war was that, since they were being taken at a price in gold which represented about 40-per-cent discount, there was being created "an additional indebtedness to the extent of the difference between the amount received for our securities and their par value, every fraction of which we shall ultimately have to pay in gold, in addition to the interest."[11] Actually, however, the obligations were being sold on no better terms within the country; and in either case it was a matter of borrowing 60-cent dollars later to repay 100-cent dollars. Obviously, the burden of the debt would be increased as the dollar appreciated to parity with gold. The bondholders would, of course, gain thereby whether they were Europeans or Americans.

If it could be seen, however, that the imports which occasioned

[9] *Report of the Special Commissioner of the Revenue*, 1869, pp. xxvii-xxix.
[10] *Treasury Report*, 1866, p. 12.
[11] *Report of the Comptroller of the Currency*, 1865, p. 66.

this flow of securities to Europe were largely capital goods which would increase the productive power of the country and yield a return more ample than the cost of obtaining them, the arrangement could be said to have been economically sound. This seems not to have been the case, at least to the extent that it should have been:

> Our importations of goods have been increased by nearly the amount of the bonds which have been exported. Not one dollar in five of the amount of the five-twenties now held in England and upon the continent has been returned to the United States in the form of real capital.[12]
>
> Our bonds have been largely paid for in articles for which no nation can afford to run in debt—for articles which have neither stimulated industry nor increased the productive power of the country, which have, in fact, added nothing to the national wealth. A reference to the custom-house entries will substantiate the correctness of these statements. Two-thirds of the importations of the United States consist of articles which, in economical times, would be pronounced luxuries. The war and a redundant currency have brought about unexampled extravagance, which can only be satisfied by the most costly products of foreign countries.[13]

A factor which contributed to the adverse balance of trade was the necessity for shipping the greater part of American imports and exports in foreign vessels. American shipbuilding could not be encouraged, for, besides what natural advantages other countries may have had in this field, one important disadvantage to American shipbuilders was that "The high price in our depreciated paper money of the chief materials for ship-building has rendered us unable, since the war, to compete with other nations in this great industry."[14] Before 1860 more than 75 per cent of the American foreign trade had been carried in American ships. After the war the ratio was reversed, approximately 75 per cent being shipped in foreign vessels.[15] In 1872 Secretary Boutwell commented, "If the annual earnings of American vessels were eighty million instead of thirty the difference in the amount of exchange available

[12] *Treasury Report*, 1866, p. 23.
[13] *Ibid.*, 1868, p. ix.
[14] *Ibid.*, 1877, p. xli. See also David A. Wells, "The Meaning of Revenue Reform," *North American Review*, CXIII (July, 1871), 130.
[15] *Treasury Report*, 1874, p. xxxi; 1879, p. xxviii.

abroad would meet a large part of the adverse balance in ordinary years."[16]

When the return flow of government securities set in, it was due only in part to the change in the balance of trade after the panic. The gradual improvement of the public credit, sustained by the prospect of specie resumption, increased the investment quality of the bonds and in that way tended to enhance their value. Readjustment within the country to a lower price level and more stable business conditions after the worst effects of the panic had disappeared, were accompanied by an abundance of liquid capital seeking conservative investment. Yet between 1866 and 1879, in spite of the borrowing for resumption purposes, the interest-bearing portion of the debt had been reduced by $435 million.[17] This reduction was very much greater in proportion to the supply available to investors than it was in proportion to the total amount of the debt, for more than half the debt was composed of greenbacks, the bonds tied up as security for national-bank notes,[18] bonds held by the Treasury to secure government deposits in national banks, and bonds held more or less permanently by savings banks as a legal form of investment.

Thus the curtailed supply of government bonds and the increased demand for them forced their prices upward until the yield was so close to that of consols and *rentes* that the American securities ceased to offer that extra value which foreign bonds must have to compete with domestic government debt. When the difference in yield was small, European investors favored the obligations of their own governments. So too were American investors willing to pay that hidden premium which a government bond commands in its own country. In the postpanic years of idle capital, domestic investment demand grew, and within six years the $1,000 million of United States debt held abroad was reduced to a small fraction of that amount.[19] It must be noted that, other circumstances being favorable to the trend, it was the enhance-

[16] *Ibid.*, 1872, p. xxiii.

[17] *Ibid.*, 1950, p. 490.

[18] "The forced market created by the banks for the bonds enhanced the credit of the government and enabled it sooner to command better terms for its loans" (Kinley, *Independent Treasury*, pp. 113-114).

[19] In the spring of 1878 it was estimated that the amount held abroad had dwindled to $600 million. In November the estimate was only $200 million (H. Misc. Doc. No. 48, 45th Cong., 2d Sess., pp. 11-12; and *Treasury Report*, 1878, p. xviii).

ment of the government's credit more than merely the favorable change in the balance of trade which brought this about, for at the same time that government securities were being returned to the home market other American securities were being acquired by Europeans in increasing amounts as foreign capital was attracted to the United States to speed its industrial development and, in particular, to help build its railroads.

This outward and return flow of government securities during the greenback period took place with no serious disruptions of the money market either in New York or abroad. It has been seen how confidence in McCulloch's firm money-market policy prevented panic in the spring of 1866 when some European holdings were liquidated at the outbreak of war between Prussia and Austria. Again, at the beginning of the Franco-Prussian War, because of an adequate Treasury balance and a determined bond-buying policy,[20] the only effect of the disturbed financial conditions in Europe was to delay commencement of the refunding program. These were instances in which foreign money-market disturbances might have had serious effects upon the domestic market, had the Treasury not had an adequate balance and the power to buy in its obligations or otherwise place its funds in the market.

LARGE DEBT OPERATIONS IN FOREIGN MARKETS

There were times when Treasury debt-management activities might have caused serious harm in foreign money markets had not patience, care, and discretion been employed. One of these was in 1871, when Jay Cooke and his associates sold some $84 million of the 5-per-cent loan in Europe. After the bonds had all been subscribed but not yet taken up and paid for, the development of the autumn stringency in the New York money market put such pressure on some bond prices that Cooke was alarmed lest subscribers to the new loan refuse to take up their subscriptions. To remedy the situation, Boutwell increased his gold sales and bond purchases and by thus relieving the market at home tided the syndicate through the crisis.

The London money market was disturbed by the syndicate's sale of a large amount of bonds there for gold, not because gold was thereby drawn from the country but because of fear that it would be. To find a place of deposit for the subscription payments

[20] *Commercial and Financial Chronicle,* XI (July 16, 1870), 77.

while waiting for called bonds to come in for redemption was a considerable problem. Richardson, who represented the Treasury in London, finally induced Bank of England officials to open an account in his name and Boutwell's, with a declaration of trust, for the bank would not accept an account for the government. Meanwhile the London market had tightened, and it was not until the bank's officers were convinced that Richardson would not "withdraw the money and take it to New York" that the discount rate was lowered and the money market eased.[21]

Richardson thus explained the delicacy of the rather odd situation in which, it would seem, the British bankers were unnecessarily making matters difficult for themselves:

> . . . I thought it would be injurious and prejudicial to the Funded Loan to have a panic in London, in which the market price of the new loan would drop considerably below par just at a time when its price and popularity were gradually rising, and just as it was coming into great favor with a new class of investors in England, the immensely rich but timid conservatives.[22]

In this way, finally, a substantial refunding operation in a foreign market was successfully completed with little disturbance to the money markets and without transfer of specie from one country to the other. After this for some years the slow sale of the refunding bonds both at home and abroad had no important effect upon foreign markets.

The payment of the $15.5 million Geneva Award by Great Britain to the United States in September, 1873, was an instance in which a large international transfer of funds was partially effected by redemption of debt held abroad. The co-operation of the Treasury in accepting some $5 million of United States bonds acquired in England by the British government simplified the problem of transfer and eased the strain on the London money market.[23]

Another large Treasury operation directly concerned with the European money market took place when Sherman was preparing for the resumption of specie payments. Unlike the foreign sale of refunding bonds, against which compensatory purchases of called

[21] Letter of William A. Richardson to Secretary Boutwell, Jan. 25, 1872, quoted in Boutwell, *op. cit.*, II, 194-199.

[22] *Ibid.*, p. 196.

[23] *Commercial and Financial Chronicle*, XVII (Aug. 16, 1873), 214.

bonds were made, the sale of the resumption bonds was intended to result in a movement of gold to New York. The acquisition of gold for resumption was prior in importance to refunding, yet it was a far more complex and delicate matter and was necessarily a gradual operation. A substantial withdrawal of gold from Europe in a short period of time would have lowered bank reserves there, discount rates would have been raised, and a return flow of gold from the United States induced. At the same time, pressure on the money market would have lowered bond prices and prevented further sale or exchange of refunding bonds as well as the sale of additional resumption bonds.[24]

Although hampered for a time by the threat of greenback and free-silver legislation, the sale of the resumption issues progressed without serious effect upon the London market. The transfer of gold to the United States took place as desired, and the gold remained within the country. The balance of trade being favorable to the United States, and the amount of Federal bonds abroad being reduced to a low point and thus less apt to substitute for gold in settling the balance, it was natural for gold to move in the direction which it did.

Altogether it was a large transaction, which, if hastily or awkwardly handled, would have quickly disturbed foreign markets and jeopardized resumption. Here again, skill, and also co-operation, played a highly important part in the measures which were taken to implement the final achievement of monetary policy in the greenback period.

The employment of a syndicate which included the foremost banking houses of the world was well worth the relatively small commission paid to the members of it. The almost instinctive knowledge of markets which the leaders of the syndicate possessed, their broad grasp of international financial trends, their timing and skill in supporting the market when it was required and in disposing of the bonds as the market permitted without disturbing the price, and the many contacts and sources of information which the members of these firms possessed were of the highest value to the Treasury.[25]

To Sherman, and also to his colleague in the Treasury Department, Charles F. Conant, who was stationed in London as funding

[24] *Specie Resumption and Refunding of National Debt, passim.*
[25] *Ibid.*

agent, should be accorded high recognition for the parts they played in this successful venture in a foreign money market. Sherman's comprehension and steadfastness of purpose and Conant's keen observation of the markets and his great diligence did much to make the European sale of the resumption bonds and the transfer of the proceeds to the United States a successful operation.

Effect on Production, Distribution, and Consumption

Few statistics are needed as background for discussion of the role of the debt in the formation and distribution of wealth following the Civil War. Certain trends should be made clear, however: The wealth of the country increased, real wages rose, goods and commodity prices and farm income declined, and private indebtedness increased.[26]

The debt, even at its highest point, was not, of course, the controlling force in the national expansion. It was rather a qualifying and directing influence the effect of which depended upon the way in which it was managed. Had there been no debt, or had the debt been twice as large, the tremendous natural and social forces at work would certainly have continued, at a different rate undoubtedly, probably along somewhat different lines, and with adjustments and adaptations which can only be conjectured. The

[26] The average annual per-capita increase in the national wealth was $22.56 between 1860 and 1870, and $39.65 between 1870 and 1880 (U. S. Census, *Wealth, Debt, and Taxation.* Washington: Government Printing Office, 1907, I, 33).

The average of relative wages in gold weighted according to importance on the basis of the 1860 level as 100 was 68.7 in 1865 and 139.4 in 1879 (*S. Rept.* No. 1394, 52d Cong., 2d Sess., I, 14; see also Mitchell, *Gold, Prices, and Wages,* pp. 102-103).

The relative average of prices in gold for farm products on the basis of 1860 as 100 was 167.1 in 1864 and 98.4 in 1879. An index for the prices in currency of articles in common use shows a decline, from 190.7 in 1865 to 96.6 in 1879 (*S. Rept.* No. 1394, 52d Cong., 2d Sess., I, 10-11; see also Mitchell, *Gold, Prices, and Wages,* pp. 26-27).

Private debt, which was small at the end of the war, increased with the industrial expansion of the East, the agricultural development of the West, the boom of speculation, and the rapid extension of the railway system. The panic and its aftermath merely interrupted a long-term trend (*Treasury Report,* 1865, pp. 12-13; *Commercial and Financial Chronicle,* XII, Feb. 25, 1871, 229-230; George Paish, *The Trade Balance of the United States, S. Doc.* No. 579, 61st Cong., 2d Sess., pp. 176-178; A. M. Sakolski, *The Great American Land Bubble,* New York: Harper and Brothers, 1932, Chaps, xiii-xiv; Buck, *The Agrarian Crusade, passim;* John D. Hicks, *The Populist Revolt,* Minneapolis: The University of Minnesota Press, 1931, *passim;* Frederick A. Cleveland and Fred W. Powell, *Railroad Promotion and Capitalization in the United States,* New York: Longmans, Green, & Co., 1909, *passim*).

need for saving and capital investment, for example, was so great that regardless of the status of the debt and the effects of its management, saving would have taken place. How much, by whom, and after what series of adjustments, with suffering and loss—if the debt had been so badly managed that its earlier effects were cataclysmic—can only be guessed. But saving was the great need of the nation, and regardless of how much this need might be obscured by the mechanics of money and credit, taxation, and Federal-debt management, an energetic people in a favorable natural and political environment could be expected to return to the path of reality.[27]

It is important to note how the debt was distributed. Practically all of the original borrowing had been within the country, but before 1873 at least $1,000 million of the obligations had come into the possession of foreign holders. By 1879 most of this amount had been returned to the United States, so that the debt was again largely a domestic one. At first the war debt had wide ownership among the people. This was partly due to the effort made to obtain popular subscriptions, but more largely to the nature of the various obligations and the use made of them when evidences of debt were disbursed in place of money. The greenbacks were, of course, currency, and they continued throughout to circulate as a medium of exchange. By 1879, when funding was completed, ownership of the interest-bearing part of the debt had become highly concentrated. Official estimates made in 1880 indicate that more than 82 per cent of it was held in amounts of $10,000 and over.[28] Thus, most of the debt was held within the country by institutions and wealthy individuals.

The war debt was "dead weight" debt. However necessary and beneficial it was to borrow and spend without limit in order to win, nothing was created that was directly tangible and productive

[27] ". . . the experience of another year reaffirms the principle . . . that the progress and growth of the country, through its elements of vitality, viz., great national resources and an inherent spirit of energy and enterprise in the people, are in a great degree independent of legislation, and of the impoverishment and disorder which the occurrence of a long war has necessarily occasioned" (*Report of the Special Commissioner of the Revenue,* 1869, pp. iii-iv).

[28] Cf. U. S. Census, *Report on Valuation, Taxation, and Public Indebtedness in the United States* (47th Cong., 2d Sess. H. Misc. Doc. No. 42, Pt. 7, 1884), pp. 489-491.

The widest distribution of the Federal debt at this time was in New England, where about 36 per cent of all government-bond holders held approximately 11 per cent of the interest-bearing debt (*ibid.,* p. 492).

and that yielded a return applicable to the service and reduction of the debt. In creating the debt, savings had been borrowed and future savings anticipated. The debt instruments were the symbols of the wealth destroyed as well as the promise to restore that wealth to those who had contributed it, or to their successors. Peacetime production could be expected eventually to replace the wealth destroyed by war. But, as the debt ran on, the interest payments required that part of the wealth being produced be drawn away from the producers and paid as income to those who held the debt.

These interest payments were the immediate cost of the debt. Repayment of the principal, as it might take place, was a further expenditure, more within the control of the government, but regarded, in theory at least, as an eventuality. Whatever funds were to be disbursed to meet these expenses of debt had to be obtained as revenue over and above that required to pay the other expenses of the government. Since there was a Treasury surplus each year, disbursements on account of the debt continually exceeded interest requirements. But interest was by far the larger outlay. The average annual reduction of principal was $32.6 million, while the average annual interest charge was $117.1 million. The average annual expenditure on debt was therefore $149.7 million. This, when compared to the average annual total expenditures of $192.5 million, other than for debt, indicates the magnitude of Treasury disbursements solely on account of debt in the fiscal years 1866 through 1879.[29]

The debt most directly influenced the creation and distribution of wealth and the formation of capital through the process of its redemption. As the revenue drawn from the people by means of a highly regressive tax system was sluiced through the Treasury and into the hands of private investors who surrendered their government bonds for it, the money was largely reinvested in the obligations and equities of private industry. What had come from the enforced savings of many who would have raised their standards of living, had the incidence of taxation been otherwise, became capital. Thus as government debt was paid, some investors were obliged to replace their holdings of government promises with claims to newly created wealth, and in this way the abstinence of certain classes resulted in the production of more capital goods and

[29] Calculations based on data in *Treasury Report*, 1950, pp. 451, 490.

fewer customers' goods. But the ownership of this additional amount of permanent, productive wealth did not devolve upon those whose sacrifice had made the production possible. The regressive tax system, through the medium of the debt, transferred it into other hands. The nation was the richer in productive facilities, but the ownership of its wealth was being concentrated in a small portion of the population.

Interest payments received by holders of government obligations, whether individuals or institutions, undoubtedly resulted in far less capital investment. The interest paid to institutions was eventually transferred to beneficiaries or stockholders as income to be spent or saved by the recipients. It seems reasonable to believe that the greater part of this income from government securities, whether directly or indirectly received, was spent for purposes of consumption. In this case it can be said that those who paid the taxes consumed fewer goods than they had been paid for producing. So far as the recipients of interest also paid taxes, the discrepancy was lessened, but the concentration of the debt in the hands of a few made such cases exceptional.

Thus, to the degree that taxation limited consumption, the reduction of government debt enforced savings and tended to allocate more of the nation's resources to the production of capital goods. At the same time, the reduction in interest charges permitted additional debt payment, with the same result. The reduction of taxes which occurred up to 1872 gave more consuming power to the lower-income groups, and because of the thrifty few, a part of this undoubtedly became savings. Although less consuming power was then transferred through the Treasury to the holders of government securities, the income from reinvestment by those whose holdings were redeemed sustained their consuming power.

The fiscal and monetary policies of the government in this period affected most severely the agricultural and laboring parts of the population. Farmers suffered most. The average farm was heavily mortgaged at a high rate of interest. Most farmers were obliged to buy their supplies and equipment on credit. As debtors, they were especially straitened by the gradual appreciation of the greenback currency. The fluctuating value of that medium of exchange also added to the expense of marketing their products. The great decline in the prices for agricultural commodities further reduced

the farmers' income, and the tariff weighed heavily on his costs of production as well as his cost of living. Many of his products were sold at competitive world prices, but as a consumer of manufactured goods he paid prices made high by the protective tariff. Even those whose plight was the most wretched and whose debts overwhelmed them, contributed, nevertheless, toward the reduction of the Federal debt. The complex process which concealed this fact from most farmers spared them its grim irony. It was no wonder, however, that the farming class organized politically and struck out blindly against what it supposed was the source of its ills and that it favored radical debt and currency measures.

On labor, especially the less skilled, the impact of Federal finance was also severe, as the processes described above have indicated. Unlike the farmers, however, this part of the population was less burdened by debt. The appreciation of the currency and the abundance of farm produce brought lower prices by which they benefited; and, as has been shown, real wages were gradually rising. Workers took some part in the third-party movements of the time, but their real concern remained higher wages and fewer hours of work.

It was the manufacturing, commercial, and financial interests which benefited most from the growth of national wealth in this period. However this wealth was distributed, it did further the creation of additional wealth. Eventually there was to come about a more equitable system of distribution.

CHAPTER XIII

A Summary of Debt-Management Objectives, 1865-1879

ALTHOUGH THE modern view of debt-management objectives is much broader than that of the post-Civil War period, the foregoing study shows that debt-management policy, even at that time, went far beyond mere concern with the size or burden of the debt. How the great Civil War debt dominated the loan markets, and how, through the interrelationship of debt policy and monetary policy, its management affected every aspect of the economy, is the important lesson which that period offers the future.

It is notable that each of the Secretaries of the Treasury comprehended well enough the general problem of the depreciated currency and the low state of the public credit and that each understood the means at his disposal for dealing with it. Yet in one or another way each was limited in his power to resolve the problem either by forces beyond his control—such as the will of Congress, public opinion, financial trends, and international events—or by his own nature and judgment. McCulloch's firm policy of currency contraction was limited by acts of Congress; Boutwell and Richardson pursued a policy of debt reduction and refunding, but failed to employ the expedient which would probably have been most effective at that time, namely, a determined restriction of the currency circulation; Bristow and Morrill continued to reduce and refund the debt, but waited for more authority from Congress to deal with the currency; Sherman, using the authority he had, joined debt policy with monetary policy and vigorously executed a plan which restored the value of the currency and re-established the public credit.

Following is a summary of both the narrower and the broader objectives of debt-management policy as ascertained in the foregoing investigation:

Between 1865 and 1879 the maturity structure of the debt went through three phases. At first only about 40 per cent of it was in funded form, the rest being short-term, floating, and non-interest-bearing debt. It was a major part of debt policy to bring the latter under control by means of conversion into 6-per-cent bonds redeemable in five years and payable after twenty years. Although this form of security was not the most satisfactory to investors and was believed to have some adverse effect upon the status of the debt abroad, it made future refunding more readily possible.

These five-twenties were gradually refunded into three bond issues having maturities respectively of 10, 15, and 30 years. The 30-year maturity—the largest of the three issues by far—was in part an attempt to "tailor" the debt to meet the preference of investors.

At the end of the war the whole structure of the debt was a bewildering complexity of maturities, rates, and terms of payment. This situation had come about during the war, when the need to borrow—however and wherever possible—was urgent. After the war, however, it was believed that the complex structure of the debt tended to alienate investors and retard improvement of the public credit. Through conversion, refunding, and redemption the debt was eventually greatly simplified.

Reduction in the interest charge on the debt was delayed by the necessity of carrying out the conversion operations at a high rate. The interest cost was actually somewhat more in 1868 and only slightly lower in 1870 than it had been in 1866. By 1879, however, it had been reduced by nearly a third. Debt policy had given controllability of the debt and enhancement of the public credit precedence over saving in interest charges.

Two specialized devices for enhancing the value of government securities were tax exemption of principal and interest, and the sinking fund. No attempt was made to use tontines, annuities, lotteries, or other such attractions. The idea of a capital levy for the reduction of debt—a proposal which every so often has appeared in the history of British debt management—seems never to have been seriously mentioned in America during this period.

Control of the floating and short-term debt—an important objective in the years immediately after the war—was achieved through conversion. Later, control over a large part of the debt

with respect to its further refunding and payment was lost when 30-year noncallable bonds were used to refund bonds of shorter maturities. This was an unfortunate arrangement, for it placed a large part of the debt out of control of the government for a long period in which interest rates were low and surplus revenues were large. The loss finally resulting from this error in policy was very great.

The distribution of the debt was a matter of serious concern, especially with regard to foreign holdings. During and after the war, government securities found their way abroad in increasing amounts until about half the interest-bearing debt was externally held. Until 1870, however, the sale of the securities directly in Europe was contrary to policy. The low state of the public credit and the sentiment against borrowing abroad both contributed to this. After 1870 it was almost continually the policy to sell bonds in Europe, but the sales were solely for refunding and resumption purposes. Foreign investment capital thus was not directly raised through government borrowing, although the outflow of government securities appears, to some extent, to have brought in new capital. It would have been sound economy for the government to have borrowed abroad even to redeem its domestic debt, for there was a large supply of foreign capital and a large demand for domestic capital.

The internal distribution of the debt was at times the subject of attention; and all the secretaries from Chase to Sherman appear to have favored as wide a distribution among the population as possible. The financial measures of the war did spread the debt quite widely, but thereafter it concentrated more and more in the possession of a relatively small number of holders. The only positive actions taken to give the debt wider distribution in the postwar years were in 1877, when Sherman sold $75 million in denominations of $50 and $100 directly to small subscribers, and again in 1879, when $40 million worth of refunding certificates in denominations of $10 was offered to the public. These attempts to democratize the debt had little effect upon the concentration of holdings. In 1880 a study made by the Treasury for the Census Office indicated that approximately 82 per cent of the debt was held in amounts over $10,000.

Thus a considerable part of debt management was concerned

directly with the debt itself. Debt management was also, however, a support to other fiscal policy so far as it helped to enhance the public credit and permit sale of the resumption bonds on favorable terms. Besides this, it helped to sustain the protective-tariff system, which yielded such large revenues that the main outlet for the surplus was through redemption of debt. Since governmental expenditure outside the immediate scope of government was not seriously considered, the policy of debt payment did not limit other fiscal policies after the war taxes had been removed. No substantial reduction in the tariff was desired by the administrations in power.

An important objective of debt management was to counteract the ill effects of the debt, especially in its earlier, short-term form. These activities were directed, as far as possible, at compensating for the rigidities and inadequacies of the Independent Treasury system, the unit system of banking, and the inelastic currency. Debt-management policy was thus distinctly an aid to monetary policy and was, in fact, a part of it. It gave elasticity to an otherwise inelastic currency system. The amount of greenbacks in circulation could be temporarily reduced by allowing surplus revenue to accumulate in the Treasury and by selling Treasury gold. It could be increased simply by redeeming securities as they came due and by buying securities in the open market. The national-bank-note currency was maintained by reason of the long maturity date of a large quantity of refunding and resumption bonds issued late in the 1870's.

The proposal that the government borrow in order to finance a program of full employment would have been startling in a period when the philosophy of laissez faire greatly limited the role of the government in the economy. Yet there were times, especially after the panic of 1873, when such an idea would have seemed good to many people. The demand for "more money," particularly for more greenbacks and for silver, was the equivalent of this. There was, however, no idea of compensatory spending to lessen the extremes of the business cycle. Even during the severe depression following the panic, the debt was reduced to some extent in each year. Economy in government operations was considered highly desirable.

Although reducing the extremes of the business cycle was not

a part of debt-management policy, the Treasury was continually concerned with the shorter-term fluctuations in the loan and investment markets, for these were the very center of the nation's business and financial life. As the occasion required, they were restrained or eased by the actions of the secretaries in varying the amount of currency and gold held in the Treasury, in increasing some forms of debt (such as the temporary deposits and the compound-interest notes, under McCulloch), in withdrawing and reissuing greenbacks, and in redeeming debt in sufficient amounts, when possible, to meet the requirements of the situation. These actions had an important effect both upon business activity and upon the shorter-term trends of prices, especially when debt management was related to the accumulation and the sale of Treasury gold. Businessmen and bankers came to rely heavily upon Treasury policy to ease seasonal stringencies, for the operations of the Treasury resembled, in a rude way, those of a central bank.

The effect of debt management on the price level, in a more general way, was continuous throughout the period. Reduction of prices to a point where they would stimulate the export of goods and reduce the adverse trade balance was conceded to be a necessary part of any policy which sought to restore the public credit and bring about the resumption of specie payments. To this end, control over the currency supply was sometimes undertaken, sometimes neglected. The effect of the judicious sale of gold, in order to hold down the premium on that metal, was to restrain the rise in prices which tended to accompany depreciation of the greenbacks, Danger of stringency from gold sales was prevented, when necessary, by the compensatory purchase of bonds in the open market. These policies were concerned with the larger considerations of business stability and the national welfare.

Through its money-market operations, the Treasury could influence current rates of interest. The rate to be paid on the government's bonds, however, could only be influenced over the longer run by means of debt policies that were conducive to the enhancement of the public credit and the stability of business. There was no time when raising the rate of interest on government bonds was desirable for any purpose.

Debt management was not consciously directed toward influencing the size and the distribution of national income, yet it had an

important effect upon both. So far as it helped to maintain a stable economy, it was, of course, conducive to a fuller use of the factors of production and thereby a larger output of goods and services. Of more positive significance, however, was the effect of debt reduction, which, in conjunction with the regressive tax system, had the effect of distributing a part of the earnings of all the people to a comparatively few bondholders. This increased the rate of saving and investment and resulted in a higher national income. But it also helped to concentrate the ownership of wealth in the hands of a few.

In this way the burden of the debt fell most heavily upon the poorer classes of people. The burden was augmented by the way in which the debt had been created. Because the government's obligations had been sold for greatly depreciated paper money, far more debt was incurred than would otherwise have been necessary. Yet most of it was payable, interest and principal, in gold. In terms of the original investment, this gave a very large interest return as well as capital gain to bondholders at the expense of taxpayers. Cheap money had been borrowed, and dear money was being repaid. Moreover, the inflationary effect of the cheapened currency placed an additional tax upon the consuming power of all individuals alike.

With the resumption of specie payments and the completion of the refunding program, too great over-all objectives of debt management were achieved: the currency was brought to a parity with gold, and the public credit was fully re-established.

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Index

Abbott, Charles C., 77
Abstinence, 212
Act to Strengthen the Public Credit, 73
Adams, Henry C., 84 n., 135 n.
Agricultural products, 114
Agriculture, 213-14
Alabama claim, 94
Alaska, purchase of, 122
Anglo-American relations, 20-22, 94, 96
Annuities, 216
Argentine Republic, securities of, 93
Aspinwall and Forbes, 21
Attorney-General, opinion of, 163
Austria, war of with Prussia, 68

Balance of trade, 106, 110, 166, 180, 184, 186, 195, 202-7, 209, 219
Bank Act (England), 186
Bank checks, 156-57, 183
Bank deposits, 178, 181, 198
Bank failures, 185
Bank loans, 177-78, 181, 185
Bank notes; *see* Notes
Bank of England, 208
Bank of North America, 9
Bank reserves, 47-48, 156-57, 170, 172, 185, 197-98
Bankers, 31
Banking system, 83, 218
Banks: as depositaries, 104; first war loan underwritten by, 25; national (*see* National banks); notes pledged with, 17-18; state (*see* State banks)
Barings, 21
Bills of credit, 9
Bimetallism, 192-94
Black Friday, 92, 203
Blaine, James G., 64
Bland-Allison Act, 155-56, 194
Bland Bill, 193-94
Bodin, Jean, 132
Bond market, support of, 48-49, 52 n.
Bonds: as security for notes, 29, 152; calling of, 82, 103-4; coin payment of, 71, 73, 82; commissions on, 98, 100-104, 111; Consols, 112; discount on in Europe, 71; distribution of, 108; double interest on 104; European market for, 68, 97, 99-100, 146; 5-per-cent, 82-84, 88, 92-99, 100-103, 112, 207; Five-twenties, 22, 27, 38, 44, 62, 65, 68-69, 71, 73, 78-80 82-83, 89-90, 104, 111-12, 146, 157, 165, 216; foreign, 73, 89 n.; 4-per-cent, 82-84, 87-89, 101, 107, 110-12, 192, 195; 4½-per-cent, 82-83, 88, 90, 101-2, 104-7, 112, 192, 195; interest on, 81, 99-100, 174, 187, 219; long-term, 44, 79, 181, 185; payment for in gold, 106-7, 110, 191-92, 196; payment of in coin, 73, 82; preference for, 41, 79; premium on, 71, 88 n., 206; prices of, 68, 73, 165-66, 192, 201, 204, 206; proposal to pay in notes, 71-72, 179; purchase of, 117, 124, 185-86, 207, 219; redemption of in Europe, 111-12; refunding, *see* Refunding; relation of maturity to interest rate, 79; return of from Europe, 186; sale of above par, 41, 82; sale of below par, 51; sale of for notes, 29-30, 40, 157; sale of for resumption, 105-6, 191-92, 195; sale of in Europe, 51, 106, 194, 203, 208; sinking fund for, 83, 137-42; tax-exemption of, 143-47, 216; Ten-forties, 44, 103, 111-12; withdrawn from sale, 38; yield on in Europe, 71, 93 (*see also* Debt, Funding, Refunding)
Bounties to soldiers, 122
Boutwell, George S.: attempt of to perpetuate National Banking System, 86-87; borrowing abroad by, 99-100, 166; debt reduction policy of, 86-87, 123-25, 184, 202; estimate by of debt reduction, 114; inconsistency of, 183; monetary policy of, 180-84, 197-98; on tax exemption, 146; refunding

plan, 80-81; refunding policy of, 94, 181; sinking fund established by, 138-39; syndicate arrangement with, 101-2; term of office, 6
Bristow, Benjamin H.: economy urged by, 126; refunding policy of, 90, 97-99, 101; resumption policy of, 190-91; silver policy of, 154; sinking-fund policy of, 140; term of office, 6
British debt management, 57, 117, 216
British view of U. S. debt policy, 56
Buchanan, James, 6
Business, 68, 77, 110, 131, 133, 167-70, 173, 175, 181-82, 185, 187, 195, 197-98, 219
Business cycle, 218
Business failures, 176-78, 195
Businessmen, 119, 165

California gold mines, 180
California gold notes, 152
Capital, 99, 104-5, 113, 130, 171, 201, 206-7, 217
Capital formation, 129-30, 149, 199
Capital funds, 199, 200-14
Capital gain, 220
Capital goods, 185, 205, 213-14
Capital investment, 211
Capital levy, 130, 216
Capital market, 110
Capitalists, 165
Carey, Henry C., 56 n., 59
Central banking, 159, 186, 219
Certificates: clearinghouse, 186; 4-per-cent, 103; gold, 149; silver, 149-50; 6-per-cent, 158; 3-per-cent, 69-70, 150, 152, 157, 177
Certificates of deposit, 62, 108-10, 149, 183
Certificates of indebtedness, 36, 46-47, 62-63, 67
Chase, Salmon P.: attitude of toward bankers, 31, 160; banking reform by, 25, 28; dealings of with Cooke, 51; debt policies of, 18, 22-25, 30-32, 35, 61, 83, 151-52; gold policy of, 25-26, 31; inconsistencies of, 23-25, 30-31; "objectives" of, 35-37; regard of for public opinion, 51; relations with Congress, 32, 35; resignation of, 31, 31 n., 35; short war anticipated by, 19; term of office, 6
Checks; *see* Bank checks
Civil War, cost of, 8
Claims, deferred, 62
Clarke, Freeman, 54
Classes, 199, 220
Clearinghouse certificates, 186
Cobb, Howell, 6, 12, 18
Coin: debt payable in, 82; fractional, 149, 153; gold, 149-51; payment for bonds in, 106; payment of bonds in, 73; silver, 149, 153-55
Coinage Acts: 1853, 153-54; 1873, 154-55
Colwyn Committee, 132
Commercial credit, 169-70, 185
Commercial paper, 177, 200
Commissions, 51, 98, 100-104, 111, 209
Commodity prices; *see* Prices
Communication, 156
Compensatory spending, 218
Compound-interest notes, 47, 150, 157-58 (*see also* Notes)
Compound-interest sinking fund, 134
Conant, Charles F., 104 n., 209-10
Confederacy, credit of, 21 n.
Confidence, public, 202
Congress, 32, 35, 73, 84, 92
Consols, 206 (*see also* Bonds)
Consumers, 84, 168
Consumption, 129, 199, 210-14, 220
Continental Congress, 9
Contraction; *see* Currency
Controllability of the debt, 36-37
Conversion of debt: during war period, 39, 45; need for, 54 (*see also* Funding)
Cooke, Jay: dealings of with Chase, 51; re-engaged, 40, 51-52; reluctance to sell bonds in Europe, 22; remonstrance of, 72 n.; sale of bonds by, 53; sale of notes by, 62
Cooke, Jay & Company, 94-95, 98, 103, 207
Corning, Erastus, 32
Corporate enterprise, 110, 201
Corruption: debt as source of, 57; in Congress, 92; of courts, 92-98
Cost of living, 165, 169
Cost of production, 199
Cost of war, 10, 29-30
Courts, corruption of, 92
Credit: abundance of, 181; commercial, 169-70, 185; lack of understanding of, 19;
Credit, public: Act to Strengthen the, 73; during Revolution, 9-10; during War of 1812, 9-10; enhancement of, 42, 75-77, 88, 93, 104, 125, 164-66, 168, 174, 181, 197, 201-3, 206-7, 216, 218-19; impairment of, 7-18, 30, 62, 72-73, 78, 149, 175, 181, 193-94, 202; in Europe, 182; McCulloch's views on, 60; re-establishment of, 220; state of, 61, 73-75, 94 n., 166, 182, 189, 204
Credit expansion, 70
Credit institutions, 161-62

Credit superstructure, 175, 185, 199
Credit supply, 160-63
Creditors, payment demanded by, 15
Crisis, in England, 60, 68 (*see also* Panic)
Crops, 185
Currency: abundance of, 114, 191-92, 200; appreciation of, 167, 204, 214; bank checks as, 156-57; contraction of, 60, 70, 125, 133, 148, 157-58, 163-68, 175-80, 196-97, 202; control over, 41; debasement of, 164 n.; demand for, 175; deposit, 156-57, 197; depreciation of, 9-10, 29, 71, 167, 182, 198-99, 219-20; excess of, 172, 185; expansion of, 133, 148, 170; fiat, 10, 57-58; fluctuations in value of, 169; fractional, 45, 49, 149-50, 153-54, 190; hoarding of, 172, 176; in South and West, 182; inflation of, 10, 58, 149, 164, 170, 180, 196-99; inflexibility of, 160-63, 218; interest-bearing notes as, 47-48; kinds and amounts of, 149-50; need for, 168-71; national-bank-note, *see* Notes; notes as, *see* Notes; postage stamps as, 153; supply of, 168-71, 173-74, 196-200; state-bank-note, *see* Notes; U. S. notes as, *see* Notes; value of, 164, 167, 183, 189, 198 (*see also* Bills of credit, Certificates, Money, Notes)
Currency control, 41
Currency reform, 119 n.
Currency schemes, 177
Currency system, 83
Customs duties; *see* Taxes

"Dead weight" debt, 211-12
Debt, Federal: advantages of, 53, 58; as bank reserves, 170; as "blessing" or "burden," 53, 58; as capital, 57; as currency, 157-59; as instrument of control, 133; as outlet for surplus, 133; as security for notes, 54; as source of corruption, 57; at end of war, 44-58; authorizations of, 44; burden of, 53, 55-56, 58, 115, 117, 121, 129-32, 143, 147-48, 204, 214, 220; calling of, 103-4; comparison of with British debt, 57; concentration of, 201, 211, 213; controllability of, 36-37, 216-17; conversion of, *see* Funding, Refunding; cost of, 212; currency problems of, 133; "dead weight," 211-12; decrease in, 69; distribution of, 36, 41, 108, 117, 201, 206, 211, 217; effect of on character, 74 n.; effect of on farmer, 129-30; effect of on labor, 129-30; effect of on money supply, 149; estimates of maximum of, 50; ethical problems of, 72 n., 74; European holdings of, 55, 203-7, 211; faulty thinking about, 57; fiscal interrelationships of, 133; floating, 75; foreign market for, 217; funding of, *see* Funding, Refunding; general effects of, 218; *Gestalt* view of, 76-77; greenbacks as part of, 54-55; gross (1857-1880), 6; interest on, 36, 62, 79, 84, 112, 137, 166, 206, 212-13, 216; interest rates on, 36, 60, 79, 80, 84; legal-tender, 150, 170, 197; limit on, 82; long-term, 44, 79, 181, 185; maturities of, 44-45, 61-62, 79, 84-88, 216; maximum of, 50-51, 63-64; monetary aspects of, 133; non-interest-bearing, 45; payment of an American trait, 56; payment of assumed, 54; payment of by inflation, 58; effects of payment of, 212; enthusiasm for payment of, 52, 54, 56-57; advance payment of, 125-26; payment of in coin, 73, 82; McCulloch's view on payment of, 54; public faith in payment of, 193; tradition of payment of, 117; permanent, 57-58, 130; philosophy of, 56-57; British view of policies, 56; criticism of policies, 52; shortcomings of policies, 31-32; sources of policies, 30-35; Civil War policies, 42-43; popularization of, 106-10, 201, 211, 217; postwar issues, 49; predictions of increase in, 50; preliminary funding of, 59-77 (*see also* Funding); public interest in, 51-52, 201; rates of interest on, 36, 60, 79-80, 84; redemption of, 45, 57-58, 88 n., 111-12, 172, 197; reduction of, 52, 57-58, 60, 67, 73, 81, 113-33, 140, 148, 171, 181, 184, 197-98, 201, 212, 214, 216, 218, 220; refunding of, *see* Funding, Refunding; relation of maturity of to interest rate, 79; relation of tariff to, 127-30; reorganization of, 64; repudiation of proposed, 53, 57, 71-74, 134; return of from Europe, 203-7; Revolutionary War, 136; risk in to investors, 72-73; short-term, 10, 44, 59-78, 83, 164, 172-73, 185, 216; simplification of, 61-62, 216; sinking fund for, 134-42; structure of, 44-48; 50-51, 62-64, 68-71, 216; tax exemption of, 143-47; temporary, 45, 67, 171-72; total gross (1857-1880), 6; utility of, 36-37; wartime authorizations, 44; wartime management of, 45; wealth represented by, 53, 143,

212 (*see also* Bonds, Certificates, Notes, Funding, Refunding)
Debt, private, 167, 210
Debt, state, 93
Deficit: prewar, 11-13; postwar, 171
Deflation, 6, 196
Demand, 170, 199
Democratic National Convention, 72
Democratic Party, 175-76
Deposit currency, 156-57, 197
Deposits: bank, 178, 181, 198; temporary loan, 171-72
Depression, end of, 110
Dietzel, Karl August, 132
Discretionary powers of the Secretary of the Treasury, 47
Distribution of debt, 36, 41
Distribution of wealth, 58, 129, 199-200, 210-14, 220
Dix, John A., 6, 14-15
Dollar: depreciation of, 9-10, 31; silver, 149, 154-55 (*see also* Currency)
Double interest, 104, 111

Economic classes, 199
Economy, adaptation of the, 132
Economy in government, 218
Egypt, securities of, 93
Emergency, preparation for, 142
Employment, full, 218
Endorsement of government's obligations, 15, 17
England: national debt of, 57, 117, 132, 216; sale of bonds in, 20-21; sentiment toward Union in, 20-21 (*see also* Great Britain)
Equities, 181, 185, 212
Erie scandals, 94
Ethical problems, 72 n., 74
Europe: American securities held in, 55; attempt to borrow in, 20-23; market for bonds in, 22-23, 99-100, 106, 146, 165, 194; return of bonds from, 97
European finance, 19, 134
European investors, 206
Exchange, 130
Executive Document Series, 7
Expansion of the economy, 110
Expenditures, 11, 42, 48-49, 114, 161, 180
Exports, 182, 186
Extravagance, 205

Failures, 176-78, 195
Farm income, 210
Farm-labor alignment, 119 n., 127
Farmers, 74, 118, 129, 144, 175, 185, 213-14
Fessenden, William P.: as Chairman of Senate Finance Committee, 33; policies of, 23, 37-42, 61; re-engagement of Cooke by, 51-52; regard of for McCulloch, 51 n.; resignation of, 42; succeeds Chase, 37; term of office, 6; withholds Treasury Statement, 40
Fiat money, 10
Fiat-money party, 179
Finance: lack of experience in, 19, 60; unsound, 74
Financial authorities, 187 n.
"Financial perpetual-motion," 187
Fiscal policy; *see* Debt, Expenditures, Revenue, Taxation
Five-twenties; *see* Bonds
Floating debt, 75
Foreign borrowing, 41, 51, 166, 171, 180, 207-10
Foreign capital, 217
Foreign exchange, 186
Foreign markets, 207-10
Foreign trade, 182 (*see also* Balance of trade)
Fractional coins, 149, 153
Fractional currency, 45, 49, 149-50, 153-54
Franco-Prussian War, 93-94, 207
Free silver, 155
"Fructification," philosophy of, 56-57
Full employment, 218
Funding, preliminary, 65-71, 74-78, 164, 166, 176, 196-97 (*see also* Refunding)

Gallatin, Albert, 136, 142
Gallatin, James, 31, 33 n.
Garfield, James A., 187
Geneva Award, 96, 208
Gestalt view of government debt, 76-77
Gilfillan, James, 109
Gold: accumulation of, 172-74, 191, 195-97, 209; bonds redeemable in, 10, 82, 220; circulation of, 180; coinage of, 190; disappearance of, 150-51; interest payable in, 40-41, 220; lack of faith in, 182; payment for bonds in, 106-7, 110, 191-92, 196; premium on, 29, 31, 71 n., 82, 105, 149, 153, 166, 176, 183, 196, 200, 202-3; sale of, 163, 171, 174-75, 177, 181, 201-3, 207, 218; shipment of, 186; speculation in, 31, 153; supply of, 153, 204; transfer of, 196; Treasury stock of, 172-74, 219 (*see also* Coin)
Gold certificates, 149, 172
Gold conspiracy, 92
Gold standard, 153, 192

Grant, Ulysses S., 6, 72, 125, 188-89
Great Britain, national debt of, 57, 117, 132, 216
Greeley, Horace, 31
Greenbacks; *see* Notes, United States

Halifax Award, 195
Hamilton, Alexander, 134 n., 136
Hayes, Rutherford B., 6, 155, 193
Hepburn, A. Barton, 42-43
Homestead Bill, 14
Hooper, Samuel, 32-33
Hours of work, 214
House Executive Document Series, 7

Impeachment, 92
Income, effect of debt on, 83-84
Independent Treasury System, 13, 25-26, 128, 159-63, 218
Inducements to investors, 17, 82, 103-4, 216
Inflation, 6, 10, 58, 149, 164, 170, 180, 196-99, 202
Inflation Bill, 187-89
Inflation philosophy, 6
Inflationists, 57, 60, 73, 175, 189, 190, 192
Imports, 180, 182, 186, 203-5
Import duties; *see* Taxes
Income tax; *see* Taxes
Interest: double, 104, 111; saving of, 112, 198; payment of, 99-100, 196-98, 203, 212-13; rates of, 23-25, 36, 44-45, 60, 62, 79, 80, 84, 173, 181, 201, 219 (*see also* Bonds, Debt, Notes)
Internal Revenue, *see* Taxes
International co-operation, 192
International payments, 180, 186 (*see also* Balance of trade)
International transfer of funds, 208-10
Inventories, 169
Investment, European, 71
Investment market, 200-2
Investors: inducements to, 17, 82, 103-4, 216; preference of, 41, 79

Johnson, Andrew, 6, 57, 59-60, 73, 80, 93, 121 n.

Labor, 113, 119, 129, 144, 165, 169, 213-14
Laissez faire, 218
Land, public, 14, 17, 41
Landlords, 165
Law, John, 136 n.
Legal tender; *see* Notes
Legal Tender Acts, the, 27-29
Lewis, Joseph J., 50
Liberty, relation of debt to, 123
Liberty Bonds, 158
Liberty Loan, 143
Lincoln, Abraham, 6, 19, 33-35, 49, 52 n.
Loan Acts: June, 1858, 11; June, 1860, 12, 16; December, 1860, 14, 16; February, 1861, 15-16; March, 1861, 15-16; July, 1861, 20, 25-26; August, 1861, 20, 25; February, 1862, 134, 137; March, 1863, 38, 47; June, 1864, 38, 47; March, 1865, 41-42, 62, 64; April, 1866, 64-68; July, 1870, 81-83
Loan authorizations, unused, 16
Loans of national banks, 178
Lotteries, 216

McCulloch, Hugh: authority of, 59; background of, 60; co-operation of with Cooke, 49; debt payment estimate of, 54; disappointment of, 176; debt-reduction estimate of, 114; gold sales by, 174-75; independence of, 60; letter of to Henry C. Carey, 59; letter of to E. G. Spaulding, 59; loyalty of to President Johnson, 59-60; money market control by, 70, 171-75; opportunity of for resumption, 164-67; policies of, 56, 59-77, 121-23, 128, 137-38, 146, 163-67, 171-79, 196-97, 202; preliminary funding by, 59-77; refunding plan of, 81; surplus forecasted by, 49; tax increase proposal of, 122-23; term of office of, 6
Malthus, Thomas R., 132
Manpower, 169
Manufacturing interests, 127
Maturities; *see* Debt
Melon, John Francis, 132
Mercantilism, 166, 182
Michaelis, John David, 132
Mississippi scheme, 136 n.
Monetary Commission of 1876, 192
Monetary Policy: 1865-1868, 58, 148-79, 213; 1869-1879, 58, 180-99, 213 (*see also* Currency, Gold, Independent Treasury, Notes, Silver)
Monetary unit, depreciation of, 130
Money: fiat, 10, 58; lack of understanding of, 19; paper, 9, 58 (*see also* Currency, Gold, Notes, Silver)
Money flow, 83
Money-managers, 189
Money market, 42, 70, 97, 104-5, 125, 148, 159-63, 168-76, 178, 181, 192, 198, 203-4, 207, 209, 219; foreign, 207, 209-10
Money supply, 149, 160-63
Morrill, Justin S., 32

Morrill, Lot M.: as Senator, 85; attitude of toward sinking fund, 140; long-term bond recommendation, 90; refunding policy of, 127; resumption policy of, 127, 191; term of office of, 6

National-bank notes; *see* Notes
National Banking Acts, 27-29
National banking system, 25, 33-34, 85-87, 151-53
National banks, 29, 104, 159-63, 178
National income, 110, 114, 131, 219-20
National wealth, 110, 114, 130-31, 205, 213 (*see also* Distribution of wealth)
National welfare, 219
Non-interest-bearing debt, 45
Notes: as bank reserves, 66, 157; compound-interest, 47, 62, 66-67, 150, 157-58, 177; demand ("Old"), 26-27; exchange of for bonds, 157; 5-per-cent, 39, 45, 63, 70, 150; interest-bearing, 41, 47-48, 67; legal-tender, 47, 51, 68, 150, 157-58; national-bank, 28, 149-53, 160, 176, 178, 183, 187 n., 190, 198, 218; proposal to pay bonds in, 179; redeemable in gold, 152; 7.3-per-cent, 20-21, 23-27, 39-41, 44-45, 47, 49-50, 62, 64, 68, 70, 158, 178; state-bank, 25-26, 28-29, 150-51, 160, 176, 180; 3.65-per-cent, 20
Notes, Treasury: as drain upon Treasury, 13-16; Cobb's attitude toward, 13-14; conversion of, 47-48; discount on, 16-17; during War of 1812, 9-10; first wartime issue of, 20; ill effects of, 17-18; legal-tender, 38; of 1857, 11-13; paid to creditors, 15-16; paid to soldiers, 39; pledged as collateral, 17; redemption of, 47-48; reissued, 17-18; sale of, 14-15, 25-26
Notes, United States (Greenbacks): appreciation of, 165; as a forced loan, 28; as bank reserves, 157; as currency, 27-28, 149-50; as debt, 54-55; Boutwell's policy for, 180-84; contraction of, 64, 66, 164, 175-79; conversion of, 191; convertibility of, 27-28, 28 n.; depreciation of, 29-31, 153-54; effects of, 27-28; increase in sought, 97, 187; inflexibility of, 183-84; Lincoln's views on, 33-34; maximum of, 179, 187-88; nature of, 158-59; redemption of, 187, 190; redundance of, 183; reissue of, 183-84, 186, 188, 190; retirement of, 70 n., 164, 179, 195; sale of bonds for, 29-30, 40; substitution of, 187 n., 198; value of, 153; withdrawal of, 183-84 (*see also* Currency, Debt)

"Old" demand notes; *see* Notes
Overend-Gurney failure, 176

Pacific Railroads, 122
Panic of 1857, 11
Panic of 1873, 97, 114, 118, 125-26, 141, 149, 184-87, 198, 200, 203, 218
Par: sale of bonds above, 82; sale of bonds at, 29-30, 40, 82; sale of bonds below, 23-24, 51
Patriotism, 22-23, 52
Peace, 167
People, willingness of to be taxed, 119-20
"Perpetual-motion, financial," 187
Petty, William, 132
Pinto, Isaac, 132
Pitt, Sir William, 135
Political environment, 211
Political uncertainty, 105 n.
Poor, the, 53, 168, 220
Popular subscriptions, 40
Popularization of the debt, 106-10
Population, 116, 152, 156, 182, 188-89, 211
Postage-stamp currency, 153
Postal rates, 156
Postal Savings System, 108
Postwar problems, 50
Prejudices, public, 51
Preliminary funding; *see* Funding
Price, Richard, 135
Price level, 114, 131, 148, 164-66, 169, 196, 202, 206
Prices, 48, 105, 129, 161, 168-69, 172, 175, 178, 180, 186, 198-200, 205, 210, 213-14, 219
Production, 169, 171, 199, 210-14
Profits, 131
Prosperity, postwar, 113
Protectionists, 182
Prussia, war of with Austria, 68
Public confidence, 202
Public credit: *see* Credit
Public criticism, 52
Public debt; *see* Debt, Federal
Public lands; *see* Land
Public opinion, 51-58, 101, 167
Public prejudices, 51
Purchasing power, 131

Railroad bonds, 185
Railroad construction, 110, 181
Railroads, 113, 185
Recession, fear of, 179

"Redeem," meaning of, 190
Redemption of debt, 45, 57-58, 88 n., 111-12, 172, 197
Reduction of debt; *see* Debt
Refunding: bonds authorized for, 82; Boutwell's plan for, 80-81; Boutwell's policy in, 181; completion of, 110-12, 163; criticisms of, 92-112; delay in, 93-95, 207; effect of, 105, 197, 201; 5-per-cent loan, 82-85, 89-90, 92-99, 102; 4½-per-cent loan, 102-7, 192; 4-per-cent, 103, 105, 107, 111, 192; interest rates for, 166; interest saved by, 112; McCulloch's plan for, 81; maturities for, 83, 216; preparation for, 78-81; sales abroad for, 208; summary of, 112; syndicate for, 104-6 (*see also* Bonds, Debt)
Refunding Act, 73, 81-94, 139, 163, 190
Refunding Bill, 1868, 79-80
Refunding certificates, 109-10
Rentes, 206
Republican National Convention, 72
Republicans, 189
Repudiation, 53, 57, 59-60, 71-74, 164 n., 201
Repudiation, universality of, 164 n.
Requisitions, unpaid, 49
"Reserve," the, 186, 188
Reserve, specie, 192
Reserve for resumption, 195
Reserves, bank, 170, 172, 197-98
Resources, use of, 129
Resumption: Boutwell's policy for, 182-83; Bristow's attitude on, 190-91; conditions essential for, 186; debt payment an aid to, 125; delay of, 180; effect of, 110; Grant's opinion on, 184; Morrill's attitude on, 191; objective of, 164, 168, 173, 181; opportunity for, 164-67, 196; opposition to, 190-96; popular desire for, 165; postponement of, 179; preparation for, 83 n., 148, 154, 163, 190-96, 209, 218; prospect of, 206; reserve for, 195; Richardson's views on, 184; sale of bonds for, 105-6, 191-92, 195; threat to, 196, 198 (*see also* Specie payments)
Resumption Act: denunciation of, 127; effect of, 203; provisions of, 152-55, 189-90; repeal of sought, 107, 192; Sherman's defense of, 193-94
Revenue, 11, 16, 42, 49, 113, 119, 124, 127, 162-63, 168, 190-92, 196, 201, 212, 218
Revolutionary War, financing of, 9-10, 19, 136
Ricardo, David, 135 n.
Richardson, William A.: debt reduction policy of, 125, 184; economy proposal of, 126; European negotiations of, 100-101; greenbacks reissued by, 183-84, 186; inconsistency of, 184; London assignment of, 208; monetary policies of, 184-87, 198; sinking-fund policy of, 140; term of office, 6
Ross, Edward A., 142
Rothschilds, 95

Sacrifice, 213
Savings, 110, 129-30, 171, 185, 202, 211-13, 220
Scarcity, 169
Schemes, financial, 187
Schenck, Robert C., 87, 93
Secretary of the Treasury, powers of, 32, 41, 47, 84
Securities: export of, 203; tax-exempt, 143-47 (*see also* Bonds, Certificates, Debt, Funding, Notes, Refunding)
Security prices, 68, 73, 165-66, 192, 200-201, 204, 206
Sherman, John: ability of, 209-10; tactics of, 190, 194; debt distribution policy of, 108-10; defense of Resumption Act by, 193-94; gold accumulated by, 173; objectives of, 127; opinion of on Refunding Act, 88; opposition of to Loan Act of 1866, 65-66; popularization of debt by, 106-10; preparation for resumption by, 163, 191-96; responsibility of for Refunding Act, 91; resumption policy of, 203; sale of refunding bonds by, 103; silver recommendation of, 155; sinking-fund policy of, 140-41; syndicate contract terminated by, 105-6, 108; term of office, 6; views on refunding, 85
Shipbuilding, 205
Short-term debt; *see* Debt
Silver: legal-tender quality of, 154-55; remonetization of, 107, 192-96, 198; price of, 154-55
Silver certificates, 149-50
Silver coin, 149, 153-55
Silver controversy, 154-56, 192-96, 198
Silver dollar, 149, 154-55
Sinking fund: Adams's criticism of, 135 n.; anomaly of, 141; British experience with, 134-35; contractual nature of, 138, 142; deficiencies in, 141; definition of, 134; disregard of, 137-38; establishment of, 138-39, 216; fallacy of, 135; Fessenden's attitude toward, 41; Gallatin's attitude toward,

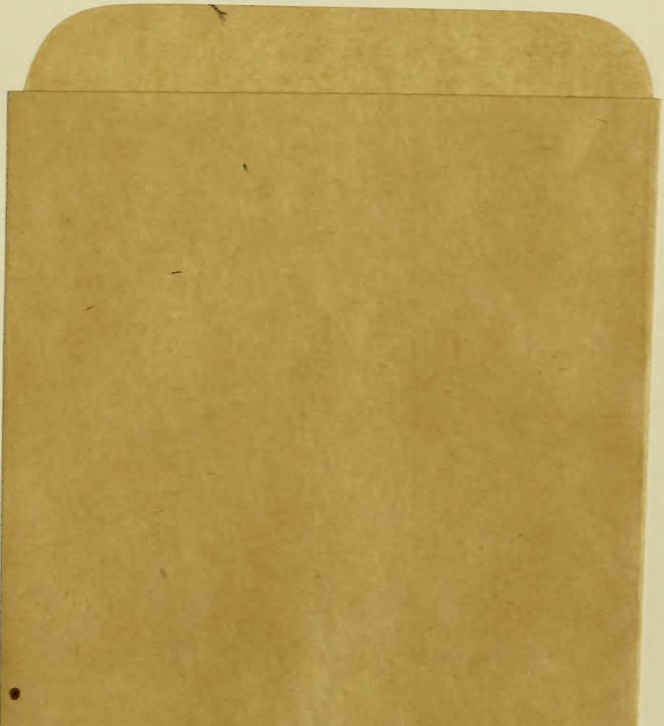
142; Gallatin's reorganization of, 136; Hamilton's, 134 n., 136; impracticality of, 142; in Loan Act of 1862, 134; McCulloch's attitude toward, 137-38; of 1817, 137; operations of, 83; Pitt's use of, 135; policies of the Secretaries, 138-41; Price's scheme for, 135; provision for, 137-38; purchases for, 125, 140; relation of surplus to, 138; requirements of, 82-83, 127; Ricardo's criticism of, 135 n.; Ross on, 142; simplification of, 139; special fund for, 139; statement of, 139; theory of, 134-37
Slavery, attitude toward in England, 21
Solvency, threat to government's, 83
South Sea Bubble, 136 n.
Sovereignty, 147
Spaulding, Elbridge G., 32, 59
Special-interest groups, 115
Specie: demand for in Europe, 68; export of, 55; payment in, 25-26; stock of, 130
Specie payments: prewar, 180; suspension of, 20, 25-27, 149, 160 (*see also* Gold, Resumption)
Specie reserve, 192
Speculation, 10, 70, 92, 161, 164, 167, 170, 172-74, 176-79, 181, 197, 202-4
Spending, compensatory, 218
Spinner, Francis E., 100, 126
Standard of living, 212
State banks, 159-60
State debt, 93
Stevens, Thaddeus, 32
Stock-market crisis, 177, 185
Stocks, 200
Stuart, John A., 52 n.
Sumner, Charles, 85-86
Supreme Court, legal-tender decisions, 61
Surplus, 15, 17, 49, 93, 113, 122, 124, 127, 133, 138, 161
Suspension of specie payments; *see* Specie payments
Syndicate, 95-99, 101-2, 104-8, 207, 209

"Tailoring" the debt, 216
Tariff, 83, 115, 119, 122-25, 127-30, 214, 218
Tariff Act of 1857, 11
Tax exemption, 34, 144-47
Tax policy, 113-33
Tax reduction, 85, 115, 122, 132
Taxation: acceptance of by people, 119-20, 125; burden of, 121, 127; incidence of, 212; progressive, 119 n.; regressive, 120, 129, 220; relation of to debt reduction, 113-33
Taxes: customs duties, 16, 115, 120, 163 n., 181; excise, 119; income, 115-16, 119-20, 124-25, 127, 131, 143; inheritance, 116, 119, 120-21, 143; internal, 116; license, 119
Taxpayers, 220
Temporary loans, 45-46
Ten-forties; *see* Bonds
Third-party movements, 214
Thomas, Philip F., 6
Tontines, 216
Trade, balance of; *see* Balance of trade
Transition from war to peace, 48-50
Transportation, 182
Treasury: action of during panic, 185; balance in, 62, 67-68, 171-74, 179, 184, 197-98, 207; control of money market by, 171-75; deposits of, 197; loan deposits with, 45-46, 171-74; monthly statement of, 40; Secretary of, *see* Secretary of the Treasury
Treasury notes; *see* Notes
Treasury surplus; *see* Surplus
Trent affair, the, 20-21, 27
Turkey, securities of, 93

United States notes; *see* Notes
Utility of the debt, 36-37

Van Trump, Mr., 1,000-year maturity proposed by, 88
Von Stein, L., 132

Wages, 169, 210
Wagner, Adolf, 132
Walker, Robert J., 21
War: between Austria and Prussia, 68, 207; cost of, 29-31; Franco-Prussian, 93-94, 207; preparation for, 57
War of 1812, 9-10, 19
Wealth: accumulation of, 129-30, 200; concentration of, 220; consumption of, 129, 199, 210-14, 220; destruction of, 212; distribution of, 58, 199-200, 210-14, 220; formation of, 210-14; government debt as, 55, 143; national, 110, 114, 130-31, 205, 213; production of, 199, 210-14
Wealthy, advantages of debt to, 53
Welfare, 127-28, 219
Wells, David A., 118
Whiskey ring, 92
White, Horace, 156
Wholesale prices; *see* Prices
World War I, cost of, 8



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